



# Agenda

**Subject:** Agenda for the 103<sup>rd</sup> meeting of the AUASB  
**Venue:** ASIC offices, 100 Market Street Sydney  
**Time:** Wednesday 12 September 2018, 8.30am – 5.00pm

\* NB: Agenda items 1, 2, 3 and 9 are closed sessions

Time	Agenda Item No.	Resp.
8.30am	<b>1. Preliminary Session*</b>	
	1.1 Welcome (verbal update)	RS
	1.2 AUASB Declarations of Interest	RS
	1.3 Approval of Minutes of Previous AUASB Meetings	RS
	1.4 Matters Arising from Previous Meetings	MZ
	1.5 AUASB Speaking Register	RS
	1.6 Update from the AUASB Chair (verbal update)	RS
	1.7 AUASB meeting register	RS
	1.8 NZAuASB Update (verbal update)	RB
9:15am	<b>2. Audit Committee Survey*</b>	Anne W/RS
10:00am	<b>3. Audit Quality Update*</b>	RH/RS
10:30am	<b>Break</b>	
10:50am	<b>4. ED ASA 315 – Feedback to IAASB ED</b>	Anne W/JR
11:50am	<b>5. Review of September 2018 IAASB Papers</b>	
	5.1 AUPs	RH/RL
	5.2 Emerging Forms of External Reporting	MM / Jo
	5.3 ISQC 1	MZ / Gareth
	5.4 ISA 220	TA
1:00pm	<b>Lunch</b>	
1:45pm	<b>Review of September 2018 IAASB Papers (cont)</b>	
	5.5 ISQC 2	MM / Gareth
	5.6 Other international	RH

Time	Agenda Item No.	Resp.
2:45pm	<b>6. AUASB Glossary</b>	AW
3:10pm	<b><i>Break</i></b>	
3:30pm	<b>7. AUASB Technical Work Program Update</b>	
	7.1 AUASB Technical Work Program Update	MZ
	7.2 AUASB Forward Agenda	MZ
	7.3 Safe Harbour Response	TA
	7.4 GS 012 (verbal update)	MZ
	7.5 Climate change update	MM
	7.6 ACNC legislative review update (verbal update)	TA
4:15pm	<b>8. Other Business</b>	
	8.1 AUASB August Newsletter (for noting)	MZ
4:30pm	<b>9. Review and discussion of annual performance statement* (verbal update)</b>	RS
5:00pm	<b>10. Close</b>	



# AUASB Board Meeting Summary Paper

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AGENDA ITEM NO. **4.1.1**

Meeting Date: 12 September 2018

Subject: ED 01/18 *Proposed Auditing Standard ASA 315 Identifying and Assessing the Risks of Material Misstatement*

Date Prepared: 28 August 2018

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☒ Action Required

☐ For Information Purposes Only

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## Agenda Item Objectives

1. To obtain the AUASB's feedback and views on ED 01/18 *Proposed Auditing Standard ASA 315 Identifying and Assessing the Risks of Material Misstatement* (ED 315) in order to identify matters:
  - a) to be included in the AUASB's submission to the IAASB;
  - b) to discuss with our stakeholders at the upcoming roundtables; and
  - c) which may be considered as compelling reasons for Australian specific content.

## Background

2. The IAASB's objective in re-issuing ISA 315 is to establish a more appropriate and robust risk assessment process, as well as:
  - a) focus on scalability;
  - b) deal with changing technology and its impact on business risks and the audit process;
  - c) enhance application of professional scepticism;
  - d) to clarify the nature and extent of the procedures to be conducted over internal controls; and
  - e) develop further guidance and tools to support implementation.
3. In July 2018, the IAASB released for comment ED ISA 315 with submissions due by 2 November 2018.
4. The AUASB is seeking feedback on ED 315 via:

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*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*

- a) ED 315 and ED 02/18 *Proposed Auditing Standard ASA 2018-1 Amendments to Australian Auditing Standards* (Conforming and consequential amendments arising from the proposed revisions to ASA 315) which were released on 7 August in Australia for public comment, with responses due 15 October 2018.
  - b) Roundtables in the following locations:
    - Perth - 20 September 2018
    - Hobart - 25 September 2018
    - Adelaide - 2 October 2018
    - Canberra - 3 October 2018
    - Brisbane - 10 October 2018
    - Sydney - 11 October 2018
    - Melbourne - 12 October 2018
  - c) The AUASB-NZAASB webinar recorded by the IAASB ISA 315 Task Force leader Fiona Campbell has been communicated to our stakeholders via our newsletter and is available via our website, and includes an invitation to provide comments to the AUASB.
5. The IAASB has requested feedback on very detailed questions, which are included in Appendix 1. The matters included in section 2 and the questions for the AUASB in section 3 of this paper, cover the questions from the IAASB. In addition the roundtable discussions based on these questions, as well as stakeholder written submissions, will further inform the AUASB when responding to the IAASB.

### **Structure of this paper**

6. This paper is set out as follows:
- Section 1 – Overview of ASA 315 and key changes from extant ASA 315
  - Section 2 – Matters identified to date for discussion
  - Section 3 – Actions and questions for the AUASB
  - Section 4 – Conforming amendments
  - Section 5 – Timetable
  - Section 6 – Other matters

### **Section 1 – Overview of ED 315 and key changes from extant ASA 315**

7. In summary the main changes are:
- a) New introductory paragraphs which provide a summary of the standard and key concepts.

- b) There are a number of new and revised definitions, notably significant risk and relevant assertions. Refer to section 2 for analysis of the new definitions for significant risks and relevant assertion. No other issues were noted.
- c) Inherent risk factors and a new concept of spectrum of inherent risk is used when determining significant risks. Refer section 2 below.
- d) Whilst the overall number of requirements has increased, many are an expansion of the existing requirements in practice, providing more detail on how to perform risk assessment and identify controls relevant to the audit, including information technology (IT) and general IT controls. The following are new:
- ◆ Requirement to separately identify inherent and control risk at the assertion level.
  - ◆ Explicitly requires the auditor to assess controls risk as maximum if not testing operating controls.
  - ◆ Enhanced and more detailed requirements in relation to how to identify and when to test design and implementation of controls relevant to the audit including IT, and general IT controls. Refer section 2 below for further discussion.
  - ◆ Identify significant risks based on the assessment of inherent risk ie. new definition of significant risk.
  - ◆ New standback provision. Refer section 2 below for further discussion.
- e) The standard is now much longer mainly due to more explanatory materials and appendices.

## **Section 2 – Matters identified to date for discussion**

8. The following includes the matters previously raised by the AUSAB on previous drafts of ED 315, as well as additional items noted by the ATG on review of the final ED 315.

Matter	ATG view
<ul style="list-style-type: none"> <li>Concern that the standard was overly complex and the order was not correct ie. identifying ROMM before assessing IR and CR</li> </ul>	<ul style="list-style-type: none"> <li>The introductory paragraphs have been updated and explain the key concepts and flow of the standard well. The introductory paragraphs explain that risk assessment is “iterative and dynamic” and the auditor develops initial potential ROMMs based on the understanding of the entity and its environment and the applicable financial reporting framework. They continue to assess the ROMMs through the risk assessment process.</li> <li>The IAASB have prepared three flowcharts to assist with understanding of ED 315.</li> <li>The comparison of ED 315 to extant ISA 315 demonstrates that there are more requirements in ED 315, however many are expanding on existing requirements. Refer to SEP18_4.1.2_Comparison to extant 315 for this analysis.</li> <li>The requirements have been expanded to improve the robustness of the risk assessment</li> </ul>

	<p>process. In particular identification of controls including IT.</p> <ul style="list-style-type: none"> <li>• Feedback will be sought at the roundtables as to the overall flow and understandability of the standard, including whether the flowcharts are helpful.</li> <li>• Overall the ATG is comfortable with the order of the standard, and that the enhanced requirements improve the robustness of the risk assessment process.</li> <li>• To be discussed further with the AUASB.</li> </ul>
<ul style="list-style-type: none"> <li>• The definition of significant risk has changed and includes the concept of spectrum of inherent risk. This is explained in the introductory paragraphs. The term spectrum of inherent risk isn't the requirements. Is it clear how this concept works with the inherent risks and identification of significant risks?</li> </ul>	<ul style="list-style-type: none"> <li>• This point is still valid.</li> <li>• The requirement to identify significant risks is based on the assessment of inherent risk which considers the inherent risk factors. The spectrum of inherent risk is not in the wording of the requirement but is in the definition of significant risk.</li> <li>• There is explanatory material to assist A221 – A230.</li> <li>• Is the definition of significant risk appropriate?</li> <li>• To be discussed further with the AUASB.</li> </ul>
<ul style="list-style-type: none"> <li>• Inherent risk factors (IRF) (which are used when assessing inherent risk) incorporates qualitative and quantitative factors.</li> </ul> <p>Concern that this may result in a low risk, large sized items being identified as a significant account.</p>	<ul style="list-style-type: none"> <li>• Still included in IRF.</li> <li>• Explanatory material A5 to A6 explains the IRF and includes quantitative as an other IRF. Refer also A222.</li> <li>• The ATG are of the view that it is appropriate to include quantitative factors in the IRF. IRFs are used to assess inherent risk which paragraph 48 of ED 315 requires the auditor to assess inherent risk by assessing the likelihood and <u>magnitude</u> of material misstatement.</li> <li>• It is appropriate to consider the size when considering ROMM.</li> <li>• To be discussed further with the AUASB.</li> </ul>
<ul style="list-style-type: none"> <li>• Definition of relevant assertions is when there is a reasonable possibility of a material misstatement. Reasonable possibility is defined as where the likelihood of a material misstatement is more than <u>remote</u>.</li> </ul> <p>Concern that reasonable possibility and more than remote are different, and increased work effort where not considered necessary. ie. will result in more significant accounts.</p>	<ul style="list-style-type: none"> <li>• Concern still exists and noted for feedback to the IAASB.</li> <li>• Will be discussed at the roundtables to gather stakeholder's views.</li> <li>• To be discussed further with the AUASB.</li> </ul>
<ul style="list-style-type: none"> <li>• Consider whether definitions of class of transaction and account balances is required as there is a risk auditors may disaggregate items.</li> </ul>	<ul style="list-style-type: none"> <li>• Will be discussed at the roundtables to gather stakeholder's views.</li> <li>• To be discussed further with the AUASB.</li> </ul>

<ul style="list-style-type: none"> <li>ED 315 Paragraph 27 Control Environment – includes items which are difficult to gather evidence on.</li> </ul>	<ul style="list-style-type: none"> <li>Paragraph 27 has not changed from the previous draft ISA 315, however there is new explanatory material (A105 and following) which assists including how to gather this evidence.</li> <li>To be discussed further with the AUASB.</li> </ul>
<ul style="list-style-type: none"> <li>ED 315 paragraph 31 (b) – should there be a significance test?</li> </ul>	<ul style="list-style-type: none"> <li>This has not changed. However note that wording is “determine whether” which allows the auditor to use professional judgement.</li> <li>To be discussed further with the AUASB.</li> </ul>
<ul style="list-style-type: none"> <li>ED 315 paragraph 34 and explanatory material A 131 – A135, refers to consideration of the work performed by internal audit.</li> <li>ASA 610 includes an Australian compelling reason difference to the ISA in relation to prohibition of using the work of internal audit for direct assistance.</li> </ul>	<ul style="list-style-type: none"> <li>This raises the potential for an Aus paragraph in the explanatory material re-stating that using the work of internal audit for direct assistance is prohibited.</li> <li>To be discussed further with the AUASB.</li> </ul>
<ul style="list-style-type: none"> <li>ED paragraph 35(a) (ii) “information about events and conditions” - is too broad.</li> </ul>	<ul style="list-style-type: none"> <li>This has not changed.</li> <li>To be discussed further with the AUASB.</li> </ul>
<ul style="list-style-type: none"> <li>ED 315 paragraphs 36, 39 – 41 includes more explicit / enhanced requirements in relation to how to identify and when to test design and implementation of controls relevant to the audit, including IT and general IT controls.</li> </ul>	<ul style="list-style-type: none"> <li>The requirements and explanatory material has been significantly enhanced from extant 315. In many instances the requirements are clarifying what should have been done and make sense.</li> <li>Now explicitly requires design and implementation testing for GITCs relevant to the audit.</li> <li>To be discussed further with the AUASB.</li> </ul>
<ul style="list-style-type: none"> <li>ED 315 paragraph 52 is a new requirement and is a stand back provision requiring the auditor to reassess classes of transactions, account balances and disclosures which have not been assessed as significant.</li> </ul>	<ul style="list-style-type: none"> <li>This is a double check that the risk assessment has been performed properly.</li> <li>Intended to drive an evaluation of the completeness of the identification of significant classes of transactions, account balances and disclosures. Required for Material classes of transactions, account balances and disclosures, which have not been deemed significant.</li> <li>Note that ISA 330 has a similar purpose but is different as results in substantive procedures being performed on any material class of transaction, account balance, or disclosures which haven’t been identified as significant.</li> <li>To be discussed further with the AUASB.</li> </ul>
<ul style="list-style-type: none"> <li>The explanatory material includes more extensive guidance throughout on scalability for “smaller and less complex entities” which is changed from the term “smaller entities” in the extant ISA 315. Note that the Task Force considered “smaller or less complex” however</li> </ul>	<ul style="list-style-type: none"> <li>Paragraph 13 of ED 315 explains scalability and the concept of smaller and less complex entities. It also says that some of the considerations may be useful in audits of larger and less complex entities.</li> <li>To be discussed further with the AUASB.</li> </ul>

determined “and” to be appropriate, as complexity is the major factor in relation to scalability.	
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### **Section 3 – Action and questions for the AUASB**

9. Read ED 315 in order to provide feedback and discuss:

- a) The issues noted above in section 2.
- b) Are there other matters identified by the AUASB which should be discussed with stakeholders at the roundtable for consideration to be included in the submission to the IAASB?
- c) Has ED 315 been appropriately restructured, clarified and modernised in order to promote a more consistent and robust risk assessment process?
  - (a) Are the flowcharts helpful and should they be included in the final Standard?
  - (b) Are the introductory paragraphs helpful?
- d) Are the requirements and application material sufficiently scalable?
- e) Does the AUASB agree with the approach to automated tools and techniques? ie. inclusion of examples to illustrate how these may be used in an audit. Any other areas where they should be included?
- f) Will the enhancements support appropriate exercise of professional scepticism?
- g) Are there any potential compelling reasons identified?

10. The following is also available to assist the AUASB in its review of ED 315:

- a) SEP18\_4.1.2\_Comparisontoextant315 for a comparison and analysis of the requirements of ED 315 compared to extant ISA 315.
- b) The IAASB’s explanatory memorandum explains in detail the background on all significant changes - [Exposure Draft, ISA 315 \(Revised\), Identifying and Assessing the Risks of Material Misstatement | IFAC](#)
- c) The IAAAB’s ED 315 Flowcharts:
  - (a) SEP18\_4.1.5\_ISA315riskassessmentflowchart
  - (b) SEP18\_4.1.6\_ISA315internalcontrolflowchart
  - (c) SEP18\_4.1.7\_ISA315ITenvironflowchart

### **Section 4 – Conforming amendments**

11. Proposed conforming amendments are included in SEP18\_4.1.4\_ED 0218 Proposed Auditing Standard ASA 2018-1 Amendments to Australian Auditing Standards (Conforming and consequential amendments arising from the proposed revisions to ISA 315). Refer SEP18\_4.1.4\_ED0218Conformingamendments.
12. The conforming amendments in ASA 540 *Auditing Accounting Estimates and Related Disclosures* are not included in ED 03/18 *Proposed Auditing Standard ASA 540 Auditing Accounting Estimates and*



*Related Disclosures*, as ISA 540 was approved by the IAASB before the conforming amendments as a result of ED 315 were finalised. These conforming amendments are included in ED 02/18.

13. Most conforming amendments are due to changes in terminology and won't have a significant impact. No issues have been identified by the ATG in these amendments, and this will be considered further once feedback is received from stakeholders to ED 02/18.

## **Section 5 – Timetable**

As agreed at the AUASB meeting on 31 July 2018:

20 September – 12 October 2018	Roundtables in Perth, Hobart, Adelaide, Canberra, Brisbane, Sydney, Melbourne (in conjunction with ASA 540)
15 October 2018	Comment period closes
24 October 2018	Draft ED IAASB submission sent to AUASB
29 October 2018	AUASB meeting to approve submission to IAASB
2 November 2018	Send final submission to IAASB

## **Section 6 - Other Matters to Consider**

### ***NZAuASB***

14. NZAuASB have issued ED 315 in New Zealand and are holding roundtables in August and September 2018. The AUASB will continue to liaise with NZAuASB about ED 315 and its response to the IAASB.

### ***Compelling Reasons Assessment***

15. The AUASB will also be informed about potential compelling reasons based on feedback from stakeholders.
16. Refer to section 2 above for a potential compelling reason in relation to internal audit. The AUASB will consider this further including any other matters based on feedback from stakeholders. No other compelling reasons have been identified to date.

## **Material Presented**

Agenda Item 4.1.1                      SEP18\_4.1.1\_ED0101ASA315BMSP  
   SEP18\_4.1.2\_Comparisontoextant315  
   SEP18\_4.1.3\_ED315  
   SEP18\_4.1.4\_ED0218Conformingamendments  
   SEP18\_4.1.5\_ISA315riskassessflowchart  
   SEP18\_4.1.6\_ISA315internalcontrolflowchart  
   SEP18\_4.1.7\_ISA315ITcontrolsflowchart

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## **Action Required**

No.	Action Item	Deliverable	Responsibility	Due Date	Status
1.	Refer section 3		AUASB	12 September 2018	

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## Exposure Draft Questions

Stakeholders are asked to respond to the AUASB on the following questions in order to inform us when responding to the IAASB:

### ED 01/18

1. Has ED 01/18 been appropriately restructured, clarified and modernised in order to promote a more consistent and robust process for the identification and assessment of the risks of material misstatement. In particular:
  - (a) Do the proposed changes help with the understandability of the risk identification and assessment process?
  - (b) Are the [flowcharts](#), prepared by the IAASB, helpful in understanding the flow of the standard (i.e., how the requirements interact and how they are iterative in nature)? If yes, should they be included in the final Standard?
  - (c) Will the revisions promote a more robust process for the identification and assessment of the risks of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6–28 of the IAASB’s Explanatory Memorandum.
  - (d) Are the new introductory paragraphs helpful?
2. Are the requirements and application material of ED 01/18 sufficiently scalable, including the ability to apply ED 01/18 to the audits of entities with a wide range of sizes, complexities and circumstances?
3. Do stakeholders agree with the approach taken to enhancing ED 01/18 in relation to automated tools and techniques, including data analytics, through the use of examples to illustrate how these are used in an audit (see Appendix 1 of the IAASB’s Explanatory Memorandum for references to the relevant paragraphs in ED 01/18)? Are there other areas within ED 01/18 where further guidance is needed in relation to automated tools and techniques, and what is the nature of the necessary guidance?
4. Do the proposals sufficiently support the appropriate exercise of professional scepticism throughout the risk identification and assessment process? Do you support the proposed change for the auditor to obtain ‘sufficient appropriate audit evidence’<sup>1</sup> through the performance of risk assessment procedures to provide the basis for the identification and assessment of the risks of material misstatement, and do you believe this clarification will further encourage professional scepticism?
5. Do the proposals made relating to the auditor’s understanding of the entity’s system of internal control<sup>2</sup> assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks or material misstatement? Specifically:
  - (a) Have the requirements related to the auditor’s understanding of each component of the entity’s system of internal control been appropriately enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?

<sup>1</sup> See paragraph 27 of the IAASB’s Explanatory Memorandum and paragraph 17 of ED 01/18

<sup>2</sup> Paragraphs 25–44 and A89–A200 of ED 01/18

- (b) Have the requirements related to the auditor's identification of controls relevant to the audit<sup>3</sup> been appropriately enhanced and clarified? Is it clear how controls relevant to the audit are identified, particularly for audits of smaller and less complex entities?
  - (c) Do you support the introduction of the new IT-related concepts and definitions? Are the enhanced requirements and application material related to the auditor's understanding of the IT environment, the identification of the risks arising from IT and the identification of general IT controls sufficient to support the auditor's consideration of the effects of the entity's use of IT on the identification and assessment of the risks of material misstatement?
6. Will the proposed enhanced framework for the identification and assessment of the risks of material misstatement result in a more robust risk assessment? Specifically:
- (a) Do you support separate assessments of inherent and control risk at the assertion level, and are the revised requirements and guidance appropriate to support the separate assessments<sup>4</sup>?
  - (b) Do you support the introduction of the concepts and definitions of 'inherent risk factors'<sup>5</sup> to help identify risks of material misstatement and assess inherent risk? Is there sufficient guidance to explain how these risk factors are used in the auditor's risk assessment process?
  - (c) In your view, will the introduction of the 'spectrum of inherent risk' (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks?
  - (d) Do you support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and their relevant assertions? Is there sufficient guidance to explain how they are determined (i.e., an assertion is relevant when there is a reasonable possibility of occurrence of a misstatement that is material with respect to that assertion),<sup>6</sup> and how they assist the auditor in identifying where risks of material misstatement exist?
  - (e) Do you support the revised definition,<sup>7</sup> and related material, on the determination of 'significant risks'? What are your views on the matters presented in paragraph 57 of the IAASB's Explanatory Memorandum relating to how significant risks are determined on the spectrum of inherent risk?
7. Do you support the additional guidance in relation to the auditor's assessment of risks of material misstatement at the financial statement level,<sup>8</sup> including the determination about how, and the degree to which, such risks may affect the assessment of risks at the assertion level?
8. What are your views about the proposed stand-back requirement in paragraph 52 of ED 01/18 and the proposed revisions made to paragraph 18 of ASA 330 and its supporting application material? Should either or both requirements be retained? Why or why not?

<sup>3</sup> See ED 01/18, paragraphs 39-40 and paragraphs 37-40 of the IAASB's Explanatory Memorandum

<sup>4</sup> Paragraphs 45-50 and A201-A235 of ED 01/18.

<sup>5</sup> See paragraph 48 of the IAASB's Explanatory Memorandum and paragraphs 16(f), A5-A6 and A83-A88 of ED 01/18.

<sup>6</sup> See footnote 26 of the IAASB's Explanatory Memorandum.

<sup>7</sup> Paragraphs 16(k) and A10, and A229-A231 of ED 01/18.

<sup>8</sup> Paragraphs 47 and A215-A220 of ED 01/18.

9. Effective date: the IAASB have proposed that the standard will be effective for financial reporting periods commencing on or after 15 December 2020, which is anticipated to be approximately 18 months after approval of the final ISA. Do you think this is a sufficient period to support effective implementation of the new standard?

*ED 02/18*

10. With respect to the proposed conforming and consequential amendments to:
- (a) ASA 200 (including Appendix 2), ASA 240 and ED 03/18, are these appropriate to reflect the corresponding changes made in proposed ASA 315?
  - (b) ASA 330, are the changes appropriate in light of the enhancements that have been made in proposed ASA 315, in particular as a consequence of the introduction of the concept of general IT controls relevant to the audit?
  - (c) The other ASAs as presented in Appendix 1, are these appropriate and complete?
11. Do you support the proposed revisions to paragraph 18 of ASA 330 to apply to classes of transactions, account balances or disclosures that are 'quantitatively or qualitatively material' to align with the scope of the proposed stand-back in proposed ASA 315?
12. Effective Date: the IAASB have proposed that the standard will be effective for financial reporting periods commencing on or after 15 December 2020, which is anticipated to be approximately 18 months after approval of the final ISA 315. Do you think this is sufficient period to support effective implementation of the new standard?

**Australian specific questions (for both ED 01/18 and 02/18)**

The AUASB is especially interested in stakeholders views on:

- 13. Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?
- 14. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
- 15. Whether there are any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
- 16. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the main changes to the requirements of the proposed standard? If significant costs are expected, the AUASB would like to understand:
  - (f) Where those costs are likely to occur;
  - (g) The estimated extent of costs, in percentage terms (relative to audit fee); and
  - (h) Whether expected costs outweigh the benefits to the users of audit services?

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| 17. | What, if any, implementation guidance auditors, preparers and other stakeholders would like the AUASB to issue in conjunction with the release of ASA 315 (specific questions/examples would be helpful). |
| 18. | Are there any other significant public interest matters that stakeholders wish to raise?  |



## Attachment to AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**        **4**  
**Meeting Date:**        12 September 2018  
**Subject:**                ED 315 Comparison to extant ASA 315  
**Date Prepared:**        28 August 2018

### Matters to Consider

This comparison of ED 315 to extant ASA 315 has been prepared to assist the AUASB in its review of ED 315.

<b>Proposed ASA 315 – ED 2018/1</b>	<b>Extant ASA 315 – Issued 2009 and amended to 2015</b>	<b>ATG Comment</b>
<b>Scope of this Auditing Standard</b> 1. This Auditing Standard deals with the auditor’s responsibility to identify and assess the risks of material misstatement in the financial report.	<b>Scope of this Auditing Standard</b> 1. This Auditing Standard deals with the auditor’s responsibility to identify and assess the risks of material misstatement in the financial report, through understanding the entity and its environment, including the entity’s internal control.	Minor change in line with change in title of the standard.
<b>Key Concepts in this ASA</b> 2. ASA 200 deals with the overall objectives of the auditor in conducting an audit of the financial report, <sup>9</sup> including to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. <sup>10</sup> Audit risk is a function of the risks of material misstatement and detection risk. ASA 200 explains that the risks of material misstatement may exist at two levels: <sup>11</sup> the overall financial statement level; and the assertion level for classes of transactions, account balances and disclosures. ASA 200 further requires the auditor to exercise professional judgement in planning and performing an audit, and to plan and perform an audit with professional scepticism recognising that circumstances may exist that cause the financial report to be materially misstated. <sup>12</sup>	<b>No equivalent paragraph</b>	Introductory paragraphs to assist with understanding key concepts and flow of the standard. No issues noted.
3. Risks at the financial statement level relate pervasively to the financial report as a whole and potentially affect many assertions. Risks of material misstatement at the assertion level consist of two components, inherent and control risk: <ul style="list-style-type: none"> <li>• Inherent risk is described as the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.</li> <li>• Control risk is described as 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 controls.</li> </ul>	<b>No equivalent paragraph</b>	



Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>4. The required understanding of the entity and the environment, the applicable financial reporting framework, and the system of internal control forms the basis for the auditor's identification of risks of material misstatement. The identification of risks of material misstatement at the assertion level is performed before consideration of any controls. The auditor does so based on a preliminary assessment of inherent risk that involves identifying those risks for which there is a reasonable possibility of material misstatement. In this ASA the assertions to which such risks of material misstatement relate are referred to as 'relevant assertions,' and the classes of transactions, account balances and disclosures to which the relevant assertions relate are referred to as 'significant classes of transactions, account balances and disclosures.'</p>	<p><b>No equivalent paragraph</b></p>	
<p>5. For the identified risks of material misstatement at the assertion level, a separate assessment of inherent risk and control risk is required by this ASA. The auditor assesses the inherent risk by assessing the likelihood and magnitude of material misstatement, and by taking into account inherent risk factors. Inherent risk factors individually or in combination increase inherent risk to varying degrees. As explained in ASA 200, inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others. The degree to which inherent risk varies, is referred to in this ASA as the 'spectrum of inherent risk.'</p>	<p><b>No equivalent paragraph</b></p>	

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>6. 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 (that is, control risk is assessed as less than maximum). The auditor's understanding of the system of internal control forms the basis for the auditor's intentions about whether to place reliance on the operating effectiveness of controls. That is, the auditor may identify specific controls that address the identified risks of material misstatement and for which the auditor intends to test operating effectiveness. If the auditor does not intend to test the operating effectiveness of controls related to certain identified risks of material misstatement,, the auditor's assessment of control risk cannot be reduced for the effective operation of controls with respect to the particular assertion (that is, control risk is assessed at maximum).</p>	<p><b>No equivalent paragraph</b></p>	
<p>7. The auditor's assessment of the risks of material misstatement at the assertion level is based on the auditor's assessments of inherent risk and control risk at the assertion level. The auditor designs and performs further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level. The auditor also identifies and assesses the risks of material misstatement at the financial statement level in accordance with this ASA in order to design and implement overall responses to address such risks.</p>	<p><b>No equivalent paragraph</b></p>	
<p>8. Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud. Although both are addressed by this ASA, the significance of fraud is such that further requirements and guidance are included in ASA 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify, assess and respond to the risks of material misstatement due to fraud.</p>	<p><b>No equivalent paragraph</b></p>	

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>The iterative nature of the auditor’s risk assessment process</p> <p>9. The auditor’s risk assessment process is iterative and dynamic. The auditor develops initial expectations about the potential risks of material misstatement and the potential significant classes of transactions, account balances and disclosures based on the auditor’s understanding of the entity and its environment and the applicable financial reporting framework. The auditor’s understanding of the system of the internal control, and in particular the information system component, provides further information to assist the auditor in developing those expectations.</p>	No equivalent paragraph	
<p>10. After identifying the risks of material misstatement, the auditor determines the significant classes of transactions, account balances and disclosures. The auditor is also required to perform a stand-back to confirm that this identification is appropriate.</p>	No equivalent paragraph	
<p>11. The auditor’s process of assessing the identified risks of material misstatement at the assertion level also results in the auditor’s determination of any significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence.</p>	No equivalent paragraph	
<p>12. This ASA requires the auditor to revise the risk assessments and modify further overall responses and further audit procedures based on audit evidence obtained from performing further audit procedures, or if new information is obtained.</p>	No equivalent paragraph	

<b>Proposed ASA 315 – ED 2018/1</b>	<b>Extant ASA 315 – Issued 2009 and amended to 2015</b>	<b>ATG Comment</b>
<p>Scalability</p> <p>13. ASA 200 states that the Australian Auditing Standards include considerations specific to smaller entities within the application and explanatory material.<sup>13</sup> This ASA is intended for audits of all entities, regardless of size or complexity. However, the application material of this ASA incorporates considerations specific to audits of smaller entities when such entities are also less complex. Accordingly, in this context, this ASA refers to ‘smaller and less complex entities.’ While the size of an entity may be an indicator of its complexity, some smaller entities may be complex and some larger entities may be less complex. Some of the considerations however may be useful in audits of larger and less complex entities.</p>	<p><b>No equivalent paragraph</b></p>	<p>Provides guidance on the definition of smaller and less complex including that may be useful in audits of larger and less complex entities.</p> <p>No issues noted.</p>
<p><b>Effective Date</b></p> <p>14. [Deleted by the AUASB. Refer Aus 0.3]</p>	<p><b>Effective Date</b></p> <p>2. [Deleted by the AUASB. Refer Aus 0.3]</p>	
<p><b>Objective</b></p> <p>15. The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.</p>	<p><b>Objective</b></p> <p>3. The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial report and assertion levels, through understanding the entity and its environment, including the entity’s internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.</p>	<p>No change</p>
<p><b>Definitions</b></p> <p>16. For the purposes of this Auditing Standard, the following terms have the meanings attributed below:</p>	<p><b>Definitions</b></p> <p>4. For the purposes of this Auditing Standard, the following terms have the meanings attributed below:</p>	<p>There are a number of new definitions, and changes to existing definitions.</p> <p>No issues noted except where detailed.</p>

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
(a) Application controls – Controls of a preventative or detective nature that support the initiation, recording, processing and reporting of transactions or other information in the entity’s information system, the objectives of which are to maintain the reliability of such transactions and other information. Such controls may rely on information, or other controls that maintain the integrity of information, or may rely on the operation of other controls.	<b>No equivalent definition</b>	
(b) Assertions – Representations, explicit or otherwise, with respect to the recognition, measurement, presentation and disclosure of information in the financial report which are inherent in management representing that the financial report is prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing and in responding to the risks of material misstatement.  (Ref: Para: A1-A2).	(a) Assertions means representations by management and those charged with governance, explicit or otherwise, that are embodied in the financial report, as used by the auditor to consider the different types of potential misstatements that may occur.	
(c) Business risk – A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity’s ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.	(b) Business risk means a risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity’s ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.	
(d) Controls – Policies or procedures that are embedded within the components of the system of internal control to achieve the control objectives of management or those charged with governance. In this context: <ul style="list-style-type: none"> <li>• Policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.</li> <li>• Procedures are actions to implement policies. (Ref: Para. A3-A4)</li> </ul>	© Internal control means the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term “controls” refers to any aspects of one or more of the components of internal control.	

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
(e) General information technology (IT) controls – Controls related to the IT environment that support the effective functioning of application controls or the integrity of information by helping to maintain the continued operation, as designed, of the entity’s information system. General IT controls include controls over the entity’s IT processes. Also see the definition of <i>IT environment</i>		
(f) Inherent Risk Factors – Characteristics of events or conditions that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or fraud. (Ref: Para A5-A6)		
(g) IT environment – The IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this ASA: <ul style="list-style-type: none"> <li>• An IT application is a program or a set of programs that is used in the initiation, processing, recording and reporting of transactions or information.</li> <li>• The IT infrastructure is comprised of the network, operating systems, and databases and their related hardware and software.</li> <li>• The IT processes are the entity’s processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations, which includes monitoring the IT environment. (Ref: Para: A7-A8)</li> </ul>		

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
(h) Relevant assertions – An assertion is relevant to a class of transactions, account balance or disclosure when the nature or circumstances of that item are such that there is a reasonable possibility of occurrence of a misstatement with respect to that assertion that is material, individually or in combination with other misstatements. There is such possibility when the likelihood of a material misstatement is more than remote. The determination of whether an assertion is a relevant assertion is made before consideration of controls. (Ref: Para. A9)		Terms reasonable possibility vs more than remote – inconsistent and difficult to apply. Refer to section 2.
(i) Risk assessment procedures – The audit procedures designed and performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.	(c) Risk assessment procedures means the audit procedures performed to obtain an understanding of the entity and its environment, including the entity’s internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial report and assertion levels.	
(j) Significant class of transactions, account balance or disclosure – A class of transactions, account balance or disclosure for which there is one or more relevant assertions.		
(k) Significant risk – An identified risk of material misstatement: <ul style="list-style-type: none"> <li>• 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 one or a combination of the inherent risk factors affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should that misstatement occur; or</li> <li>• That is to be treated as a significant risk in accordance with the requirements of other Australian Auditing Standards.<sup>14</sup> (Ref: Para. A10)</li> </ul>	(d) Significant risk means an identified and assessed risk of material misstatement that, in the auditor’s judgement, requires special audit consideration.	This definition is important in assisting with audit quality. Is the upper end of the spectrum of risk helpful? Is this definition appropriate? Refer to section 2.

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>(l) System of Internal Control – The system designed, implemented and maintained by those charged with governance, management and other personnel, to provide reasonable assurance about the achievement of an entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. For the purposes of the Australian Auditing Standards, the system of internal control consists of five inter-related components: (Ref: Para. A11)</p> <ul style="list-style-type: none"> <li>• Control environment.</li> <li>• The entity’s risk assessment process.</li> <li>• The entity’s process to monitor the system of internal control.</li> <li>• The information system and communication.</li> <li>• Control activities.</li> </ul>		
<p><b>Requirements</b></p> <p><b>Risk Assessment Procedures and Related Activities</b></p> <p>17. The auditor shall design and perform risk assessment procedures to obtain an understanding of:</p> <ul style="list-style-type: none"> <li>(a) The entity and its environment in accordance with paragraph 23(a);</li> <li>(b) The applicable financial reporting framework in accordance with paragraph 23(b); and</li> <li>(c) The entity’s system of internal control in accordance with paragraphs 25–44</li> </ul> <p>to obtain sufficient appropriate audit evidence as the basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Ref: Para. A12-A16)</p>	<p><b>Requirements</b></p> <p><b>Risk Assessment Procedures and Related Activities</b></p> <p>5. The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial report and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Ref: Para. A1-A5)</p>	<p>No issues noted</p>



Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>18. No The risk assessment procedures shall include the following: (Ref: Para A17-A20)</p> <p>(a) Enquiries of management, of appropriate individuals within the internal audit function (if the function exists), and of others within the entity who in the auditor’s judgement may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. (Ref: Para. A21-A29)</p> <p>(b) Analytical procedures. (Ref: Para. A30-A34)</p> <p>(c) Observation and inspection. (Ref: Para A35-A36)</p>	<p>6. The risk assessment procedures shall include the following:</p> <p>(a) Enquiries of management, of appropriate individuals within the internal audit function (if the function exists) and of others within the entity who in the auditor’s judgement may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. (Ref: Para. A6-A13)</p> <p>(b) Analytical procedures. (Ref: Para. A14-A17)</p> <p>(c) Observation and inspection. (Ref: Para. A18)</p>	No change. No issues noted
<p>19. The auditor, in identifying and assessing the risks of material misstatement, shall take into account information obtained from the auditor’s acceptance or continuance of the client relationship or the audit engagement. (Ref: Para. A37)</p>	<p>7. The auditor shall consider whether information obtained from the auditor’s client acceptance or continuance process is relevant to identifying risks of material misstatement.</p>	No change. No issues noted
<p>20. If the engagement partner has performed other engagements for the entity, the engagement partner shall consider whether information obtained is relevant to identifying and assessing risks of material misstatement. (Ref: Para. A38)</p>	<p>8. If the engagement partner has performed other engagements for the entity, the engagement partner shall consider whether information obtained is relevant to identifying risks of material misstatement.</p>	No change. No issues noted
<p>21. Where the auditor intends to use information obtained from the auditor’s previous experience with the entity and from audit procedures performed in previous audits, the auditor shall evaluate whether such information remains relevant and reliable as audit evidence for the current audit. (Ref: Para. A39-A40)</p>	<p>9. Where the auditor intends to use information obtained from the auditor’s previous experience with the entity and from audit procedures performed in previous audits, the auditor shall determine whether changes have occurred since the previous audit that may affect its relevance to the current audit. (Ref: Para. A19-A20)</p>	No change. No issues noted
<p>22. The engagement partner and other key engagement team members shall discuss the application of the applicable financial reporting framework in the context of the nature and circumstances of the entity and its environment, and the susceptibility of the entity’s financial report to material misstatement. The engagement partner shall determine which matters are to be communicated to engagement team members not involved in the discussion. (Ref: Para. A41-A46)</p>	<p>10. The engagement partner and other key engagement team members shall discuss the susceptibility of the entity’s financial report to material misstatement, and the application of the applicable financial reporting framework to the entity’s facts and circumstances. The engagement partner shall determine which matters are to be communicated to engagement team members not involved in the discussion. (Ref: Para. A21-A24)</p>	No change. No issues noted

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p><b>Obtaining an Understanding of the Entity and Its Environment and the Applicable Financial Reporting Framework (Ref: Para. A47-A48)</b></p> <p>23. The auditor shall perform risk assessment procedures to obtain an understanding of the entity and its environment and the applicable financial reporting framework. In doing so, the auditor shall obtain an understanding of the following matters to provide an appropriate basis for understanding the classes of transactions, account balances and disclosures to be expected in the entity's financial report:</p> <p>(a) The entity and its environment, including:</p> <p>(i) 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; (Ref: Para A49-A63)</p> <p>(ii) Relevant industry, regulatory and other external factors; and (Ref: Para. A64-A69)</p> <p>(iii) The relevant measures used, internally and externally, to assess the entity's financial performance. (Ref: Para. A70-A78)</p> <p>(b) The applicable financial reporting framework, including: (Ref: Para.A79-A82)</p> <p>(i) How it applies in the context of the nature and circumstances of the entity and its environment, including how events or conditions are subject to, or affected by, the inherent risk factors; and (Ref: Para.A83-A88)</p> <p>(ii) The entity's accounting policies and any changes thereto, including the reasons for any such changes.</p>	<p><b>The Required Understanding of the Entity and its Environment, Including the Entity's Internal Control</b></p> <p><i>The Entity and Its Environment</i></p> <p>11. The auditor shall obtain an understanding of the following:</p> <p>(a) Relevant industry, regulatory, and other external factors and the applicable financial reporting framework. (Ref: Para. A25-A30)</p> <p>(b) The nature of the entity, including:</p> <p>(i) its operations;</p> <p>(ii) its ownership and governance structures;</p> <p>(iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and</p> <p>(iv) the way that the entity is structured and how it is financed to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial report. (Ref: Para. A31-A35)</p> <p>(c) moved to requirement 24.</p> <p>(d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. (Ref: Para. A37-A43)</p> <p>(e) The measurement and review of the entity's financial performance. (Ref: Para. A44-A49)</p>	<p>No issues noted</p>

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
24. The auditor shall evaluate whether the entity's accounting policies, and any changes thereto, are appropriate in the context of the nature and circumstances of the entity and its environment, and consistent with the applicable financial reporting framework.	11. ©The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry. (Ref: Para. A36)	No change. No issues noted
<b>Obtaining an Understanding of the Entity's System of Internal Control</b>  25. The auditor shall perform risk assessment procedures to obtain an understanding of the entity's system of internal control relevant to financial reporting, including the entity's use of IT, by understanding each of the components of internal control. For this purpose, the auditor shall address the requirements set out in paragraphs 27 to 38 of this ASA. (Ref: Para. A89-A103)	<i>The Entity's Internal Control</i>  12. The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgement whether a control, individually or in combination with others, is relevant to the audit. (Ref: Para. A50-A73)	No issues noted
26. The auditor shall identify controls relevant to the audit, and shall evaluate the design of such controls and determine whether the controls have been implemented in accordance with the requirements set out in paragraphs 39 to 42. (Ref: Para. A104)	Nature and Extent of the Understanding of Relevant Controls  13. When obtaining an understanding of controls that are relevant to the audit, the auditor shall evaluate the design of those controls and determine whether they have been implemented, by performing procedures in addition to enquiry of the entity's personnel. (Ref: Para. A74-A76)	No change. No issues noted

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>Components of the Entity's System of Internal Control</p> <p>Control Environment</p> <p>27. The auditor shall obtain an understanding of the control environment relevant to financial reporting, including understanding how the entity: (Ref: Para. A105-A110)</p> <ul style="list-style-type: none"> <li>(a) Demonstrates a commitment to integrity and ethical values;</li> <li>(b) When those charged with governance are separate from management, demonstrates that those charged with governance are independent of management and exercise oversight of the entity's system of internal control;</li> <li>(c) Establishes, with the oversight of those charged with governance, structures, reporting lines, and appropriate authorities and responsibilities, in pursuit of its objectives;</li> <li>(d) Demonstrates a commitment to attract, develop, and retain competent individuals in alignment with its objectives; and</li> <li>(e) Holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control.</li> </ul>	<p>Components of Internal Control</p> <p>Control environment</p> <p>14. The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:</p> <ul style="list-style-type: none"> <li>(a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behaviour; and</li> <li>(b) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control, and whether those other components are not undermined by control environment weaknesses. (Ref: Para. A77-A87)</li> </ul>	<p>More enhanced requirements. Application material assist with how to do this.</p>

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>28. Based on the auditor's understanding of the control environment in accordance with paragraph 27, the auditor shall evaluate whether: (Ref: Para. A111-A114)</p> <ul style="list-style-type: none"> <li>(a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behaviour; and</li> <li>(b) The strengths in those areas of the entity's control environment addressed in paragraphs 27(a) to (e) collectively provide an appropriate foundation for the other components of the system of internal control, or whether those other components are undermined by control deficiencies in the control environment component.</li> </ul>		
<p>The Entity's Risk Assessment Process (Ref: Para. A115-A116)</p> <p>29. The auditor shall obtain an understanding of the entity's risk assessment process, including the extent to which it is formalised, by understanding: (Ref: Para. A117-A119)</p> <ul style="list-style-type: none"> <li>(a) Whether, and if so, how, the entity's process: <ul style="list-style-type: none"> <li>(i) Identifies business risks relevant to financial reporting objectives;</li> <li>(ii) Assesses the significance of those risks, including the likelihood of their occurrence; and</li> <li>(iii) Addresses those risks.</li> </ul> </li> <li>(b) The results of the entity's process.</li> </ul>	<p>The entity's risk assessment process</p> <p>15. The auditor shall obtain an understanding of whether the entity has a process for:</p> <ul style="list-style-type: none"> <li>(a) Identifying business risks relevant to financial reporting objectives;</li> <li>(b) Estimating the significance of the risks;</li> <li>(c) Assessing the likelihood of their occurrence; and</li> <li>(d) Deciding about actions to address those risks. (Ref: Para. A88)</li> </ul>	<p>No real change. Paragraphs 29 – 31 are similar to 15 – 17 in extant</p>

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>30. If the auditor identifies risks of material misstatement that management failed to identify, the auditor shall evaluate whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process. If so, the auditor shall obtain an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement, and consider the implications for the auditor's evaluation required by paragraph 31.</p>	<p>16. If the entity has established such a process (referred to hereafter as the "entity's risk assessment process"), the auditor shall obtain an understanding of it, and the results thereof. If the auditor identifies risks of material misstatement that management failed to identify, the auditor shall evaluate whether there was an underlying risk of a kind that the auditor expects would have been identified by the entity's risk assessment process. If there is such a risk, the auditor shall obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or determine if there is a significant deficiency in internal control with regard to the entity's risk assessment process.</p>	
<p>31. Based on the auditor's understanding of the entity's risk assessment process in accordance with paragraph 29, and if applicable, paragraph 30, the auditor shall: (Ref: Para. A120-A121)</p> <ul style="list-style-type: none"> <li>(a) Evaluate whether the nature of the entity's risk assessment process, including its formality, is appropriate to the entity's circumstances considering the nature and size of the entity; and</li> <li>(b) If not, determine whether the lack of an appropriate risk assessment process represents one or more control deficiencies.</li> </ul>	<p>17. If the entity has not established such a process or has an ad hoc undocumented process, the auditor shall discuss with management whether business risks relevant to financial reporting objectives have been identified and how they have been addressed. The auditor shall evaluate whether the absence of a documented risk assessment process is appropriate in the circumstances, or determine whether it represents a significant deficiency in internal control. (Ref: Para. A89)</p>	<p>Enhanced but effectively no change.</p>
<p>The entity's process to monitor the system of internal control (Ref: Para. A122-A125)</p> <p>32. The auditor shall obtain an understanding of the entity's process to monitor the system of internal control, including the extent to which it is formalised, by understanding how the entity's process: (Ref: Para. A126-A128)</p> <ul style="list-style-type: none"> <li>(a) Monitors the effectiveness of controls; and</li> <li>(b) Addresses the identification and remediation of control deficiencies, including those related to the entity's risk assessment process.</li> </ul>	<p>Monitoring of controls</p> <p>22. The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control relevant to financial reporting, including those related to those control activities relevant to the audit, and how the entity initiates remedial actions to address deficiencies in its controls. (Ref: Para. A110-A112)</p>	<p>No change</p>

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
33. The auditor shall obtain an understanding of the sources of the information used in the entity's process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose. (Ref: Para. A129-A130)	24. The auditor shall obtain an understanding of the sources of the information used in the entity's monitoring activities, and the basis upon which management considers the information to be sufficiently reliable for the purpose. (Ref: Para. A121)	No change
34. If the entity has an internal audit function, <sup>15</sup> the auditor shall obtain an understanding of the nature of the internal audit function's responsibilities, its organisational status, and the activities performed, or to be performed. (Ref: Para. A131-A135)	23. If the entity has an internal audit function, <sup>1</sup> the auditor shall obtain an understanding of the nature of the internal audit function's responsibilities, its organisational status, and the activities performed, or to be performed. (Ref: Para. A113-A120)	No change

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>The Information System and Communication</p> <p>35. The auditor shall obtain an understanding of the information system relevant to financial reporting, including the related business processes, through understanding: (Ref: Para. A136-A141)</p> <p>(a) How information relating to significant classes of transactions, account balances and disclosures flows through the entity's information system, whether manually or using IT, and whether obtained from within or outside of the general ledger and subsidiary ledgers. This understanding shall include how: (Ref: Para. A142-A143)</p> <p>(i) Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, and incorporated in the general ledger and reported in the financial report; and</p> <p>(ii) Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial report.</p> <p>(b) The accounting records, specific accounts in the financial report and other supporting records relating to the flows of information in paragraph 35(a);</p> <p>(c) The financial reporting process used to prepare the entity's financial report from the records described in paragraph 35(b), including as it relates to disclosures and to accounting estimates relating to significant classes of transactions, account balances and disclosures;</p> <p>(d) The entity's IT environment relevant to (a) through (c) above. (Ref: Para. A144-A150 and Para. A180-A182)</p>	<p>The information system, including the related business processes, relevant to financial reporting, and communication</p> <p>18. The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas: (Ref: Para. A90–A92)</p> <p>(a) The classes of transactions in the entity's operations that are significant to the financial report;</p> <p>(b) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial report;</p> <p>(c) The related accounting records, supporting information and specific accounts in the financial report that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;</p> <p>(d) How the information system captures events and conditions, other than transactions, that are significant to the financial report;</p> <p>(e) The financial reporting process used to prepare the entity's financial report, including significant accounting estimates and disclosures; and</p> <p>(f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments. (Ref: Para. A93-A94)</p> <p>This understanding of the information system relevant to financial reporting shall include relevant aspects of that system relating to information disclosed in the financial report that is obtained from within or outside of the general and subsidiary ledgers.</p>	<p>Understand the entity's IT environment.</p> <p>Links to paragraph 40</p>



Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
36. The auditor shall evaluate the design of the information system controls relevant to financial reporting, by understanding how the matters in paragraph 35(a)–(d) are addressed by the entity, and implemented. (Ref: Para. A151-A157)		Explicitly requires design and implementation of information system controls.
<p>37. The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities and significant matters relevant to financial reporting, including: (Ref: Para. A158-A159)</p> <ul style="list-style-type: none"> <li>(a) Communications between management and those charged with governance; and</li> <li>(b) External communications, such as those with regulatory authorities.</li> </ul>	<p>19. The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities and significant matters relating to financial reporting, including: (Ref: Para. A97-A98)</p> <ul style="list-style-type: none"> <li>(a) Communications between management and those charged with governance; and</li> <li>(b) External communications, such as those with regulatory authorities.</li> </ul>	No change and no issues noted.
<p>Control Activities</p> <p>38. The auditor shall obtain an understanding of the control activities component by identifying the controls relevant to the audit in the control activities component in accordance with the requirements of paragraphs 39 through 41, and by evaluating their design and determining whether they have been implemented in accordance with paragraph 42. (Ref: Para. A160-A165)</p>		New to explain the process.

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>Controls relevant to the audit</p> <p>39. The auditor shall identify controls relevant to the audit, being those: (Ref: Para. A166-A167)</p> <ul style="list-style-type: none"> <li>(a) That address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; (Ref: Para. A168)</li> <li>(b) That address risks that are identified as a significant risk; (Ref: Para. A169-A173)</li> <li>(c) Over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments; (Ref: Para. A174-A175)</li> <li>(d) Controls for which the auditor plans to test the operating effectiveness in determining the nature, timing and extent of substantive testing; or (Ref: Para. A176-A178)</li> <li>(e) That, in the auditor’s professional judgement, are appropriate to evaluate their design and determine whether they have been implemented to enable the auditor to: (Ref: Para. A179) <ul style="list-style-type: none"> <li>(i) Identify and assess the risks of material misstatement at the assertion level; or</li> <li>(ii) Design further audit procedures responsive to assessed risks.</li> </ul> </li> </ul> <p>Not all controls that are relevant to financial reporting are relevant to the audit. It is a matter of the auditor’s professional judgement as to whether a control, individually or in combination with other controls, is identified as being relevant to the audit.</p>	<p>Control Activities relevant to the audit</p> <p>20. The auditor shall obtain an understanding of control activities relevant to the audit, being those the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance, and disclosure in the financial report or to every assertion relevant to them. (Ref: Para. A93-A106)</p> <p>29. If the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity’s controls, including control activities, relevant to that risk. (Ref: Para. A146-A148)</p>	<p>ED 315 includes more detail on how to identify the controls relevant to the audit. Note paragraph 39 (b) is in paragraph 29 in extant.</p> <p>No issues noted</p>

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>40. Based on the understanding obtained in accordance with paragraph 35(d), and the identification of the controls relevant to the audit in accordance with paragraph 39, the auditor shall identify the IT applications and the other aspects of the entity's IT environment that are relevant to the audit. In doing so, the auditor shall take into account whether the IT applications include or address: (Ref: Para. A180-A188)</p> <ul style="list-style-type: none"> <li>(a) Automated controls that management is relying on and that the auditor has determined to be relevant to the audit;</li> <li>(b) Maintenance of the integrity of information stored and processed in the information system that relates to significant classes of transactions, account balances or disclosures;</li> <li>(c) System-generated reports on which the auditor intends to rely on without directly testing the inputs and outputs of such reports; or</li> <li>(d) Controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.</li> </ul>		<p>Not a specific requirement in extant.</p> <p>Identify the IT applications and relevant to the audit.</p>
<p>41. For the IT applications and other aspects of the IT environment that are relevant to the audit, the auditor shall identify: (Ref: Para. A189-A193)</p> <ul style="list-style-type: none"> <li>(a) The risks arising from the use of IT; and</li> <li>(b) The general IT controls relevant to the audit.</li> </ul>	<p>21. In understanding the entity's control activities, the auditor shall obtain an understanding of how the entity has responded to risks arising from IT. (Ref: Para. A107-A109)</p>	<p>Expanded to include GITCs which support IT applications and the IT environment relevant to the audit.</p> <p>Wasn't explicitly in the extant however no issues noted.</p>

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>42. For each control identified as relevant to the audit in accordance with paragraphs 39 and 41, the auditor shall: (Ref: Para. A194-A200)</p> <ul style="list-style-type: none"> <li>(a) Evaluate whether the control is designed effectively to address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls; and</li> <li>(b) Determine whether the control has been implemented by performing procedures in addition to enquiry of the entity's personnel.</li> </ul>		<p>Evaluate design and implementation of controls relevant to the audit including GITCs.</p> <p>Not explicit in extant.</p> <p>Refer to section 2.</p> <p>Also in paragraph 26 in ED 315. Is it needed in both?</p>
<p>Control Deficiencies Within the System of Internal Control</p> <p>43. The auditor shall, in accordance with ASA 265,16 determine on the basis of the work performed in accordance with this ASA:</p> <ul style="list-style-type: none"> <li>(a) Whether one or more control deficiencies within the system of internal control have been identified; and</li> <li>(b) If so, whether the control deficiencies, individually or in combination, constitute significant control deficiencies.</li> </ul>		<p>No issues noted</p>
<p>44. The auditor shall consider the implications for the audit of one or more control deficiencies in the system of internal control, including for:</p> <ul style="list-style-type: none"> <li>(a) The assessment of control risk for risks of material misstatement at the assertion level in accordance with paragraph 50; and</li> <li>(b) Designing and implementing overall responses to address the assessed risks of material misstatement as required by ASA 330.<sup>17</sup></li> </ul>		<p>No issues noted</p>

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<b>Identifying and Assessing the Risks of Material Misstatement</b>  45. The auditor shall identify the risks of material misstatement and determine whether they exist at: (Ref: Para. A201-A210) <ul style="list-style-type: none"> <li>(a) The financial statement level, by evaluating whether the identified risks relate more pervasively to the financial report as a whole, including potentially affecting many assertions; or (Ref: Para. A207)</li> <li>(b) The assertion level for classes of transactions, account balances, and disclosures, taking into account the inherent risk factors. (Ref: Para. A208)</li> </ul>	<b>Identifying and Assessing the Risks of Material Misstatement</b>  25. The auditor shall identify and assess the risks of material misstatement at: <ul style="list-style-type: none"> <li>(a) the financial report level; and (Ref: Para. A122-A125)</li> <li>(b) the assertion level for classes of transactions, account balances, and disclosures (Ref: Para. A126-A131)</li> </ul> to provide a basis for designing and performing further audit procedures.	No change and no issues noted
46. The auditor shall determine significant classes of transactions, account balances and disclosures, and their relevant assertions, based on the identified risks of material misstatement. (Ref: Para. A211-A214)		More explicit in ED 315 than in extant paragraph 18
<i>Assessing Risks of Material Misstatement at the Financial Statement Level</i>  47. The auditor shall assess the identified risks of material misstatement at the financial statement level by: (Ref: Para. A215-A220) <ul style="list-style-type: none"> <li>(a) Determining how, and the degree to which, such risks affect the assessment of risks of material misstatement at the assertion level (Ref: Para. A227), and</li> <li>(b) Evaluating the nature and extent of their pervasive effect on the financial report to provide the basis for designing and implementing overall responses to the identified risk of material misstatement at the financial statement level in accordance with ASA 330.<sup>18</sup> (Ref: Para A216)</li> </ul>	26. For this purpose, the auditor shall: <ul style="list-style-type: none"> <li>(a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures (including the quantitative or qualitative aspects of such disclosures) in the financial report; (Ref: Para. A132-A137)</li> <li>(b) Assess the identified risks, and evaluate whether they relate more pervasively to the financial report as a whole and potentially affect many assertions;</li> <li>(c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: Para. A138-A140)</li> <li>(d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement could result in a material misstatement. (Ref: Para. A137)</li> </ul>	Clarifying and separating risks at the financial statement level from the assertion level.  No issues noted

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p><i>Assessing Risks of Material Misstatement at the Assertion Level</i></p> <p>Assessing Inherent Risk</p> <p>48. For identified risks of material misstatement at the assertion level, the auditor shall assess inherent risk by assessing the likelihood and magnitude of material misstatement. In doing so, the auditor shall take into account how, and the degree to which:</p> <ul style="list-style-type: none"> <li>(a) Identified events and conditions relating to significant classes of transactions, account balances and disclosures are subject to, or affected by, the inherent risk factors. (Ref: Para. A221-A228)</li> <li>(b) The risks of material misstatement at the financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level. (Ref: Para. A216 and A227)</li> </ul>	<p><i>Risks that Require Special Audit Consideration</i></p> <p>28. In exercising judgement as to which risks are significant risks, the auditor shall consider at least the following:</p> <ul style="list-style-type: none"> <li>(a) Whether the risk is a risk of fraud;</li> <li>(b) Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;</li> <li>(c) The complexity of transactions;</li> <li>(d) Whether the risk involves significant transactions with related parties;</li> <li>(e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and</li> <li>(f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual. (Ref: Para. A141-A145)</li> </ul>	<p>ED 315 includes the inherent risk factors when assessing inherent risk.</p> <p>Refer to section 2.</p>
<p>49. The auditor shall determine, based on the auditor's assessment of inherent risk, whether any of the assessed risks of material misstatement are significant risks. (Ref: Para. A229-A231)</p>	<p>27. As part of the risk assessment as described in paragraph 25 of this Auditing Standard, the auditor shall determine whether any of the risks identified are, in the auditor's judgement, a significant risk. In exercising this judgement, the auditor shall exclude the effects of identified controls related to the risk.</p>	<p>No change in the requirement to identify significant risks, however the definition has changed.</p>

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p>Assessing Control Risk</p> <p>50. For identified risks of material misstatement at the assertion level, the auditor shall assess control risk as follows: (Ref: Para. A232-A235)</p> <p>(a) When the auditor plans to test the operating effectiveness of controls in designing further audit procedures to be performed to respond to a risk of material misstatement at the assertion level, the auditor shall assess control risk at less than maximum. In doing so, the auditor shall take into account whether the design, implementation and expected operating effectiveness of such controls support the auditor's intended reliance thereon.</p> <p>(b) When the auditor does not plan to test the operating effectiveness of controls in designing further audit procedures to be performed to respond to a risk of material misstatement at the assertion level, the auditor shall assess control risk at the maximum.</p>		<p>Not explicit in requirements in extant.</p> <p>No issues noted</p>
<p><i>Risks for Which Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence</i></p> <p>51. The auditor shall determine, for any of the risks of material misstatement at the assertion level, whether substantive procedures alone cannot provide sufficient appropriate audit evidence (Ref: Para. A236-A239)</p>	<p><i>Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence</i></p> <p>30. In respect of some risks, the 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 or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. In such cases, the entity's controls over such risks are relevant to the audit and the auditor shall obtain an understanding of them. (Ref: Para. A149-A151)</p>	<p>Paragraph 40 then requires the controls to be identified as relevant to the audit.</p> <p>Should this be more explicit?</p>

Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p><i>Classes of Transactions, Account Balances and Disclosures that are Not Significant, but which are Material</i></p> <p>52. The auditor shall: (Ref: Para. A240-A242)</p> <ul style="list-style-type: none"> <li>(a) Identify the classes of transactions, account balances and disclosures that are quantitatively or qualitatively material, and that have not been identified as significant classes of transactions, account balances or disclosures in accordance with paragraph 46; and</li> <li>(b) Evaluate whether the auditor’s conclusion that there are no relevant assertions (that is, no related risks of material misstatement) for these classes of transactions, account balances and disclosures remains appropriate.</li> </ul>		<p>New requirement. Refer section 2.</p>
<p><i>Revision of Risk Assessment</i></p> <p>53. The auditor’s assessments of the risks of material misstatement at the financial statement level and assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the identification and assessments of the risks of material misstatement, the auditor shall revise the assessment and modify the planned overall responses or further audit procedures accordingly. (Ref: Para. A243)</p>	<p><i>Revision of Risk Assessment</i></p> <p>31. 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. In circumstances where the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment, the auditor shall revise the assessment and modify the further planned audit procedures accordingly. (Ref: Para. A152)</p>	<p>No change.</p>



Proposed ASA 315 – ED 2018/1	Extant ASA 315 – Issued 2009 and amended to 2015	ATG Comment
<p><b>Documentation</b></p> <p>54. The auditor shall include in the audit documentation:<sup>19</sup> (Ref: Para. A244-A247)</p> <ul style="list-style-type: none"> <li>(a) The discussion among the engagement team, where required in accordance with paragraph 22, and the significant decisions reached;</li> <li>(b) Key aspects of the auditor’s understanding obtained regarding the entity and its environment specified in paragraph 23 and of each of the components of the system of internal control specified in paragraphs 27, 29, 32 through 38; the sources of information from which the auditor’s understanding was obtained; and the risk assessment procedures performed;</li> <li>(c) The controls identified to be relevant to the audit in accordance with the requirements in paragraphs 39 and 41.</li> <li>(d) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level as required by paragraph 45 through 51, including significant risks, and the rationale for the significant judgements made in identifying and assessing the risks of material misstatement. (Ref: Para A245)</li> </ul>	<p><b>Documentation</b></p> <p>32. The auditor shall include in the audit documentation:<sup>2</sup></p> <ul style="list-style-type: none"> <li>(a) The discussion among the engagement team where required by paragraph 10 of this Auditing Standard, and the significant decisions reached;</li> <li>(b) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph 11 of this Auditing Standard and of each of the internal control components specified in paragraphs 14-24 of this Auditing Standard; the sources of information from which the understanding was obtained; and the risk assessment procedures performed;</li> <li>(c) The identified and assessed risks of material misstatement at the financial report level and at the assertion level as required by paragraph 25 of this Auditing Standard; and</li> <li>(d) The risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements in paragraphs 27-30 of this Auditing Standard. (Ref: Para. A153-A156)</li> </ul>	<p>Enhanced but no issues noted.</p>

**EXPOSURE DRAFT**

**ED 01/18**  
(August 2018)

# **Proposed Auditing Standard ASA 315** *Identifying and Assessing the Risks of Material Misstatement*

Issued for Comment by the **Auditing and Assurance Standards Board**



**Australian Government**

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**Auditing and Assurance Standards Board**

## **Commenting on this Exposure Draft**

Comments on this Exposure Draft should be received by no later than 15 October 2018. Comments should be addressed to:

The Chair  
Auditing and Assurance Standards Board  
PO Box 204, Collins Street West  
Melbourne Victoria 8007 AUSTRALIA

## **Formal Submissions**

Submissions should be lodged online via the “Work in Progress-Open for Comment” page of the Auditing and Assurance Standards Board (AUASB) website ([www.auasb.gov.au/Work-In-Progress/Open-for-comment.aspx](http://www.auasb.gov.au/Work-In-Progress/Open-for-comment.aspx)) as a PDF document and Word document.

A copy of all non-confidential submissions will be placed on public record on the AUASB website: [www.auasb.gov.au](http://www.auasb.gov.au)

## **Obtaining a Copy of this Exposure Draft**

This Exposure Draft is available on the AUASB website: [www.auasb.gov.au](http://www.auasb.gov.au)

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## CONTENTS

PREFACE

AUTHORITY STATEMENT

CONFORMITY WITH INTERNATIONAL STANDARDS ON AUDITING

	<i>Paragraphs</i>
<b>Application</b> .....	Aus 0.1-Aus 0.2
Operative Date .....	Aus 0.3
Introduction	
Scope of this Auditing Standard .....	1
Key Concepts in this ASA .....	2-13
Effective Date .....	14
Objective .....	15
Definitions .....	16
Requirements	
Risk Assessment Procedures and Related Activities .....	17-22
Obtaining an Understanding of the Entity and Its Environment and the Applicable Financial Reporting Framework .....	23-24
Obtaining an Understanding of the Entity's System of Internal Control .....	25-44
Identifying and Assessing the Risks of Material Misstatement .....	45-53
Documentation .....	54
Application and Other Explanatory Material	
Definitions .....	A1-A11
Risk Assessment Procedures and Related Activities .....	A12-A46
Obtaining an Understanding of the Entity and Its Environment and the Applicable Financial Reporting Framework .....	A47-A88
Obtaining an Understanding of the Entity's System of Internal Control .....	A89-A104
Understanding the Components of the Entity's System of Internal Control .....	A105-A200
Identifying and Assessing the Risks of Material Misstatement .....	A201-A243
Documentation .....	A244-A247
Appendix 1: Considerations for Understanding the Entity and its Business Model	
Appendix 2: Events and Conditions That May Indicate Susceptibility to Risks of Material Misstatement	
Appendix 3: Understanding the Entity's System of Internal Control	
Appendix 4: Considerations for Understanding General IT Controls	

## **PREFACE**

### **Reasons for Issuing ED 01/18**

The AUASB issues exposure draft ED 01/18 of proposed Auditing Standard ASA 315 *Identifying and Assessing the Risks of Material Misstatement* pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is a non corporate Commonwealth entity of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act). Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislation Act 2003*.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required, inter alia, to develop auditing standards that have a clear public interest focus and are of the highest quality. Under the Strategic Direction, the AUASB is required to have regard to any program initiated by the IAASB for the revision and enhancement of the International Standards on Auditing (ISAs) and to make appropriate consequential amendments to the Australian Auditing Standards.

### **Main Proposals**

This proposed Auditing Standard represents the Australian equivalent of the IAASB's exposure draft on proposed ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement* issued for public comment (July 2018) by the IAASB. This proposed Auditing Standard will replace the current ASA 315 issued by the AUASB in October 2009 and amended to December 2015.

This proposed Auditing Standard contains differences from the current ASA 315, as detailed in the Explanatory Memorandum Exposure draft 01/18: *Proposed Auditing Standard ASA 315 Identifying and Assessing the Risks of Material Misstatement* and Exposure draft 02/18: *Proposed Auditing Standard ASA 2018-1 Amendments to Australian Auditing Standards* (Explanatory Memorandum).

### **Proposed Operative Date**

It is intended that this proposed Auditing Standard will be operative for financial reporting periods commencing on or after 15 December 2020.

### **Main changes from existing ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment***

For the main differences between this proposed Auditing Standard and the Auditing Standard that it supersedes, ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* issued in October 2009 and amended to December 2015, refer to the Explanatory Memorandum.

### **Request for Comments**

Comments are invited on this Exposure Draft of the proposed re-issuance of ASA 315 *Identifying and Assessing the Risks of Material Misstatement* by no later than 15 October 2018.

**Proposed Auditing Standard ASA 315**  
***Identifying and Assessing the Risks of Material Misstatement***

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Stakeholders are asked to respond to the AUASB on the following questions in order to inform us when responding to the IAASB on their ED:

1. Has ED 01/18 been appropriately restructured, clarified and modernised in order to promote a more consistent and robust process for the identification and assessment of the risks of material misstatement. In particular:
  - (a) Do the proposed changes help with the understandability of the risk identification and assessment process?
  - (b) Are the flowcharts helpful in understanding the flow of the standard (i.e., how the requirements interact and how they are iterative in nature)? If yes, should they be included in the final ISA 315? ([Exposure Draft, ISA 315 \(Revised\), Identifying and Assessing the Risks of Material Misstatement IFAC](#))
  - (c) Will the revisions promote a more robust process for the identification and assessment of the risks of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6–28 of the IAASB’s Explanatory Memorandum?
  - (d) Are the new introductory paragraphs helpful?
2. Are the requirements and application material of ED 01/18 sufficiently scalable, including the ability to apply ED 01/18 to the audits of entities with a wide range of sizes, complexities and circumstances?
3. Do respondents agree with the approach taken to enhancing ED 01/18 in relation to automated tools and techniques, including data analytics, through the use of examples to illustrate how these are used in an audit (see Appendix 1 of the IAASB’s Explanatory Memorandum for references to the relevant paragraphs in ED 01/18)? Are there other areas within ED 01/18 where further guidance is needed in relation to automated tools and techniques, and what is the nature of the necessary guidance?
4. Do the proposals sufficiently support the appropriate exercise of professional scepticism throughout the risk identification and assessment process? Do you support the proposed change for the auditor to obtain ‘sufficient appropriate audit evidence’<sup>1</sup> through the performance of risk assessment procedures to provide the basis for the identification and assessment of the risks of material misstatement, and do you believe this clarification will further encourage professional scepticism?
5. Do the proposals made relating to the auditor’s understanding of the entity’s system of internal control<sup>2</sup> assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks or material misstatement? Specifically:
  - (a) Have the requirements related to the auditor’s understanding of each component of the entity’s system of internal control been appropriately enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?
  - (b) Have the requirements related to the auditor’s identification of controls relevant to the audit<sup>3</sup> been appropriately enhanced and clarified? Is it clear how controls relevant to the audit are identified, particularly for audits of smaller and less complex entities?

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<sup>1</sup> See paragraph 27 of the IAASB’s Explanatory Memorandum and paragraph 17 of ED 01/18

<sup>2</sup> Paragraphs 25-44 and A89-A200 of ED 01/18

<sup>3</sup> See ED 01/18, paragraphs 39-40 and paragraphs 37-40 of the IAASB’s Explanatory Memorandum

- (c) Do you support the introduction of the new IT-related concepts and definitions? Are the enhanced requirements and application material related to the auditor's understanding of the IT environment, the identification of the risks arising from IT and the identification of general IT controls sufficient to support the auditor's consideration of the effects of the entity's use of IT on the identification and assessment of the risks of material misstatement?
6. Will the proposed enhanced framework for the identification and assessment of the risks of material misstatement result in a more robust risk assessment? Specifically:
- (a) Do you support separate assessments of inherent and control risk at the assertion level, and are the revised requirements and guidance appropriate to support the separate assessments'?<sup>4</sup>
  - (b) Do you support the introduction of the concepts and definitions of 'inherent risk factors'<sup>5</sup> to help identify risks of material misstatement and assess inherent risk? Is there sufficient guidance to explain how these risk factors are used in the auditor's risk assessment process?
  - (c) In your view, will the introduction of the 'spectrum of inherent risk' (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks?
  - (d) Do you support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and their relevant assertions? Is there sufficient guidance to explain how they are determined (i.e., an assertion is relevant when there is a reasonable possibility of occurrence of a misstatement that is material with respect to that assertion),<sup>6</sup> and how they assist the auditor in identifying where risks of material misstatement exist?
  - (e) Do you support the revised definition,<sup>7</sup> and related material, on the determination of 'significant risks'? What are your views on the matters presented in paragraph 57 of the IAASB's Explanatory Memorandum relating to how significant risks are determined on the spectrum of inherent risk?
7. Do you support the additional guidance in relation to the auditor's assessment of risks of material misstatement at the financial statement level,<sup>8</sup> including the determination about how, and the degree to which, such risks may affect the assessment of risks at the assertion level?
8. What are your views about the proposed stand-back requirement in paragraph 52 of ED 01/18 and the proposed revisions made to paragraph 18 of ASA 330 and its supporting application material? Should either or both requirements be retained? Why or why not?
9. Effective Date: the IAASB have proposed that the standard will be effective for financial reporting periods commencing on or after 15 December 2020, which is anticipated to be approximately 18 months after approval of the final ISA 315. Do you think this is sufficient period to support effective implementation of the new standard?

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<sup>4</sup> Paragraphs 45-50 and A201-A235 of ED 01/18.

<sup>5</sup> See paragraph 48 of the IAASB's Explanatory Memorandum and paragraphs 16(f), A5-A6 and A83-A88 of ED 01/18.

<sup>6</sup> See footnote 26 of the IAASB's Explanatory Memorandum.

<sup>7</sup> Paragraphs 16(k) and A10, and A229-A231 of ED 01/18.

<sup>8</sup> Paragraphs 47 and A215-A220 of ED 01/18.

**Australian specific questions**

Stakeholders are asked to respond to the AUASB on the following questions in order to inform us when considering if any compelling reasons exist:

10. Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?
11. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
12. Whether there are any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
13. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the main changes to the requirements of the proposed standard? If significant costs are expected, the AUASB would like to understand:
  - (a) Where those costs are likely to occur;
  - (b) The estimated extent of costs, in percentage terms (relative to audit fee); and
  - (c) Whether expected costs outweigh the benefits to the users of audit services?
14. What, if any, implementation guidance auditors, preparers and other stakeholders would like the AUASB to issue in conjunction with the release of ASA 315 (specific questions/examples would be helpful)?
15. Are there any other significant public interest matters that stakeholders wish to raise?



### **AUTHORITY STATEMENT**

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 315 *Identifying and Assessing the Risks of Material Misstatement* pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with ASA 101 *Preamble to Australian Auditing Standards*, which sets out the intentions of the AUASB on how the Australian Auditing Standards, operative for financial reporting periods commencing on or after 1 January 2010, are to be understood, interpreted and applied. This Auditing Standard is to be read also in conjunction with ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

## **Conformity with International Standards on Auditing**

This Auditing Standard conforms with proposed International Standard on Auditing ISA 315 *Identifying and Assessing the Risks of Material Misstatement* issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

Paragraphs that have been added to this Auditing Standard (and do not appear in the text of the equivalent ISA) are identified with the prefix “Aus”.

This Auditing Standard incorporates terminology and definitions used in Australia.

The equivalent requirements and related application and other explanatory material included in proposed ISA 315 in respect of “relevant ethical requirements”, have been included in Auditing Standard, ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements*. There is no international equivalent to ASA 102.

Compliance with this Auditing Standard enables compliance with ISA 315.

## **AUDITING STANDARD ASA 315**

### ***Identifying and Assessing the Risks of Material Misstatement***

#### **Application**

- Aus 0.1 This Auditing Standard applies to:
- (a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with the *Corporations Act 2001*; and
  - (b) an audit of a financial report, or a complete set of financial statements, for any other purpose.
- Aus 0.2 This Auditing Standard also applies, as appropriate, to an audit of other historical financial information.

#### **Operative Date**

- Aus 0.3 This Auditing Standard is operative for financial reporting periods commencing on or after 15 December 2020. Early adoption of this Auditing Standard is permitted prior to this date.

#### **Introduction**

##### **Scope of this Auditing Standard**

1. This Auditing Standard deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial report.

##### **Key Concepts in this ASA**

2. ASA 200 deals with the overall objectives of the auditor in conducting an audit of the financial report,<sup>9</sup> including to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.<sup>10</sup> Audit risk is a function of the risks of material misstatement and detection risk. ASA 200 explains that the risks of material misstatement may exist at two levels:<sup>11</sup> the overall financial statement level; and the assertion level for classes of transactions, account balances and disclosures. ASA 200 further requires the auditor to exercise professional judgement in planning and performing an audit, and to plan and perform an audit with professional scepticism recognising that circumstances may exist that cause the financial report to be materially misstated.<sup>12</sup>
3. Risks at the financial statement level relate pervasively to the financial report as a whole and potentially affect many assertions. Risks of material misstatement at the assertion level consist of two components, inherent and control risk:
  - Inherent risk is described as the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

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<sup>9</sup> See ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

<sup>10</sup> See ASA 200, paragraph 17.

<sup>11</sup> See ASA 200, paragraphs 13(c) and 13(n).

<sup>12</sup> See ASA 200, paragraphs 15–16.

- Control risk is described as 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 controls.
4. The required understanding of the entity and the environment, the applicable financial reporting framework, and the system of internal control forms the basis for the auditor's identification of risks of material misstatement. The identification of risks of material misstatement at the assertion level is performed before consideration of any controls. The auditor does so based on a preliminary assessment of inherent risk that involves identifying those risks for which there is a reasonable possibility of material misstatement. In this ASA the assertions to which such risks of material misstatement relate are referred to as 'relevant assertions,' and the classes of transactions, account balances and disclosures to which the relevant assertions relate are referred to as 'significant classes of transactions, account balances and disclosures.'
  5. For the identified risks of material misstatement at the assertion level, a separate assessment of inherent risk and control risk is required by this ASA. The auditor assesses the inherent risk by assessing the likelihood and magnitude of material misstatement, and by taking into account inherent risk factors. Inherent risk factors individually or in combination increase inherent risk to varying degrees. As explained in ASA 200, inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others. The degree to which inherent risk varies, is referred to in this ASA as the 'spectrum of inherent risk.'
  6. 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 (that is, control risk is assessed as less than maximum). The auditor's understanding of the system of internal control forms the basis for the auditor's intentions about whether to place reliance on the operating effectiveness of controls. That is, the auditor may identify specific controls that address the identified risks of material misstatement and for which the auditor intends to test operating effectiveness. If the auditor does not intend to test the operating effectiveness of controls related to certain identified risks of material misstatement,, the auditor's assessment of control risk cannot be reduced for the effective operation of controls with respect to the particular assertion (that is, control risk is assessed at maximum).
  7. The auditor's assessment of the risks of material misstatement at the assertion level is based on the auditor's assessments of inherent risk and control risk at the assertion level. The auditor designs and performs further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level. The auditor also identifies and assesses the risks of material misstatement at the financial statement level in accordance with this ASA in order to design and implement overall responses to address such risks.
  8. Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud. Although both are addressed by this ASA, the significance of fraud is such that further requirements and guidance are included in ASA 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify, assess and respond to the risks of material misstatement due to fraud.

The iterative nature of the auditor's risk assessment process

9. The auditor's risk assessment process is iterative and dynamic. The auditor develops initial expectations about the potential risks of material misstatement and the potential significant classes of transactions, account balances and disclosures based on the auditor's understanding of the entity and its environment and the applicable financial reporting framework. The auditor's understanding of the system of the internal control, and in particular the information system component, provides further information to assist the auditor in developing those expectations.

10. After identifying the risks of material misstatement, the auditor determines the significant classes of transactions, account balances and disclosures. The auditor is also required to perform a stand-back to confirm that this identification is appropriate.
11. The auditor's process of assessing the identified risks of material misstatement at the assertion level also results in the auditor's determination of any significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence.
12. This ASA requires the auditor to revise the risk assessments and modify further overall responses and further audit procedures based on audit evidence obtained from performing further audit procedures, or if new information is obtained.

#### Scalability

13. ASA 200 states that the Australian Auditing Standards include considerations specific to smaller entities within the application and explanatory material.<sup>13</sup> This ASA is intended for audits of all entities, regardless of size or complexity. However, the application material of this ASA incorporates considerations specific to audits of smaller entities when such entities are also less complex. Accordingly, in this context, this ASA refers to 'smaller and less complex entities.' While the size of an entity may be an indicator of its complexity, some smaller entities may be complex and some larger entities may be less complex. Some of the considerations however may be useful in audits of larger and less complex entities.

#### Effective Date

14. [Deleted by the AUASB. Refer Aus 0.3]

#### Objective

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

#### Definitions

16. For the purposes of this Auditing Standard, the following terms have the meanings attributed below:
  - (a) Application controls – Controls of a preventative or detective nature that support the initiation, recording, processing and reporting of transactions or other information in the entity's information system, the objectives of which are to maintain the reliability of such transactions and other information. Such controls may rely on information, or other controls that maintain the integrity of information, or may rely on the operation of other controls.
  - (b) Assertions – Representations, explicit or otherwise, with respect to the recognition, measurement, presentation and disclosure of information in the financial report which are inherent in management representing that the financial report is prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing and in responding to the risks of material misstatement. (Ref: Para: A1-A2).
  - (c) Business risk – A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its

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<sup>13</sup> See ASA 200, paragraphs 66-68.

objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.

- (d) Controls – Policies or procedures that are embedded within the components of the system of internal control to achieve the control objectives of management or those charged with governance. In this context:
  - Policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
  - Procedures are actions to implement policies. (Ref: Para. A3-A4)
- (e) General information technology (IT) controls – Controls related to the IT environment that support the effective functioning of application controls or the integrity of information by helping to maintain the continued operation, as designed, of the entity's information system. General IT controls include controls over the entity's IT processes. Also see the definition of *IT environment*
- (f) Inherent Risk Factors – Characteristics of events or conditions that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or fraud. (Ref: Para A5-A6)
- (g) IT environment – The IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this ASA:
  - An IT application is a program or a set of programs that is used in the initiation, processing, recording and reporting of transactions or information.
  - The IT infrastructure is comprised of the network, operating systems, and databases and their related hardware and software.
  - The IT processes are the entity's processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations, which includes monitoring the IT environment. (Ref: Para: A7-A8)
- (h) Relevant assertions – An assertion is relevant to a class of transactions, account balance or disclosure when the nature or circumstances of that item are such that there is a reasonable possibility of occurrence of a misstatement with respect to that assertion that is material, individually or in combination with other misstatements. There is such possibility when the likelihood of a material misstatement is more than remote. The determination of whether an assertion is a relevant assertion is made before consideration of controls. (Ref: Para. A9)
- (i) Risk assessment procedures – The audit procedures designed and performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
- (j) Significant class of transactions, account balance or disclosure – A class of transactions, account balance or disclosure for which there is one or more relevant assertions.
- (k) Significant risk – An identified risk of material misstatement:

- 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 one or a combination of the inherent risk factors affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should that misstatement occur; or
  - That is to be treated as a significant risk in accordance with the requirements of other Australian Auditing Standards.<sup>14</sup> (Ref: Para. A10)
- (l) System of Internal Control – The system designed, implemented and maintained by those charged with governance, management and other personnel, to provide reasonable assurance about the achievement of an entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. For the purposes of the Australian Auditing Standards, the system of internal control consists of five inter-related components: (Ref: Para. A11)
- Control environment.
  - The entity’s risk assessment process.
  - The entity’s process to monitor the system of internal control.
  - The information system and communication.
  - Control activities.

## **Requirements**

### **Risk Assessment Procedures and Related Activities**

17. The auditor shall design and perform risk assessment procedures to obtain an understanding of:
- (a) The entity and its environment in accordance with paragraph 23(a);
  - (b) The applicable financial reporting framework in accordance with paragraph 23(b); and
  - (c) The entity’s system of internal control in accordance with paragraphs 25–44
- to obtain sufficient appropriate audit evidence as the basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Ref: Para. A12-A16)
18. The risk assessment procedures shall include the following: (Ref: Para A17-A20)
- (a) Enquiries of management, of appropriate individuals within the internal audit function (if the function exists), and of others within the entity who in the auditor’s judgement may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. (Ref: Para. A21-A29)
  - (b) Analytical procedures. (Ref: Para. A30-A34)
  - (c) Observation and inspection. (Ref: Para A35-A36)

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<sup>14</sup> See ASA 240 *The Auditor’s Responsibilities Relating to Fraud in an Audit of a Financial Report*, paragraph 27 and ASA 550 *Related Parties*, paragraph 18.

19. The auditor, in identifying and assessing the risks of material misstatement, shall take into account information obtained from the auditor's acceptance or continuance of the client relationship or the audit engagement. (Ref: Para. A37)
20. If the engagement partner has performed other engagements for the entity, the engagement partner shall consider whether information obtained is relevant to identifying and assessing risks of material misstatement. (Ref: Para. A38)
21. Where the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor shall evaluate whether such information remains relevant and reliable as audit evidence for the current audit. (Ref: Para. A39-A40)
22. The engagement partner and other key engagement team members shall discuss the application of the applicable financial reporting framework in the context of the nature and circumstances of the entity and its environment, and the susceptibility of the entity's financial report to material misstatement. The engagement partner shall determine which matters are to be communicated to engagement team members not involved in the discussion. (Ref: Para. A41-A46)

**Obtaining an Understanding of the Entity and Its Environment and the Applicable Financial Reporting Framework** (Ref: Para. A47-A48)

23. The auditor shall perform risk assessment procedures to obtain an understanding of the entity and its environment and the applicable financial reporting framework. In doing so, the auditor shall obtain an understanding of the following matters to provide an appropriate basis for understanding the classes of transactions, account balances and disclosures to be expected in the entity's financial report:
  - (a) The entity and its environment, including:
    - (i) 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; (Ref: Para A49-A63)
    - (ii) Relevant industry, regulatory and other external factors; and (Ref: Para. A64-A69)
    - (iii) The relevant measures used, internally and externally, to assess the entity's financial performance. (Ref: Para. A70-A78)
  - (b) The applicable financial reporting framework, including: (Ref: Para.A79-A82)
    - (i) How it applies in the context of the nature and circumstances of the entity and its environment, including how events or conditions are subject to, or affected by, the inherent risk factors; and (Ref: Para.A83-A88)
    - (ii) The entity's accounting policies and any changes thereto, including the reasons for any such changes.
24. The auditor shall evaluate whether the entity's accounting policies, and any changes thereto, are appropriate in the context of the nature and circumstances of the entity and its environment, and consistent with the applicable financial reporting framework.

**Obtaining an Understanding of the Entity's System of Internal Control**

25. The auditor shall perform risk assessment procedures to obtain an understanding of the entity's system of internal control relevant to financial reporting, including the entity's use of IT, by understanding each of the components of internal control. For this purpose, the auditor shall address the requirements set out in paragraphs 27 to 38 of this ASA. (Ref: Para. A89-A103)



26. The auditor shall identify controls relevant to the audit, and shall evaluate the design of such controls and determine whether the controls have been implemented in accordance with the requirements set out in paragraphs 39 to 42. (Ref: Para. A104)

#### Components of the Entity's System of Internal Control

##### Control Environment

27. The auditor shall obtain an understanding of the control environment relevant to financial reporting, including understanding how the entity: (Ref: Para. A105-A110)
- (a) Demonstrates a commitment to integrity and ethical values;
  - (b) When those charged with governance are separate from management, demonstrates that those charged with governance are independent of management and exercise oversight of the entity's system of internal control;
  - (c) Establishes, with the oversight of those charged with governance, structures, reporting lines, and appropriate authorities and responsibilities, in pursuit of its objectives;
  - (d) Demonstrates a commitment to attract, develop, and retain competent individuals in alignment with its objectives; and
  - (e) Holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control.
28. Based on the auditor's understanding of the control environment in accordance with paragraph 27, the auditor shall evaluate whether: (Ref: Para. A111-A114)
- (a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behaviour; and
  - (b) The strengths in those areas of the entity's control environment addressed in paragraphs 27(a) to (e) collectively provide an appropriate foundation for the other components of the system of internal control, or whether those other components are undermined by control deficiencies in the control environment component.

##### The Entity's Risk Assessment Process (Ref: Para. A115-A116)

29. The auditor shall obtain an understanding of the entity's risk assessment process, including the extent to which it is formalised, by understanding: (Ref: Para. A117-A119)
- (a) Whether, and if so, how, the entity's process:
    - (i) Identifies business risks relevant to financial reporting objectives;
    - (ii) Assesses the significance of those risks, including the likelihood of their occurrence; and
    - (iii) Addresses those risks.
  - (b) The results of the entity's process.
30. If the auditor identifies risks of material misstatement that management failed to identify, the auditor shall evaluate whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process. If so, the auditor shall obtain an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement, and consider the implications for the auditor's evaluation required by paragraph 31.

**Proposed Auditing Standard ASA 315**  
***Identifying and Assessing the Risks of Material Misstatement***

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31. Based on the auditor's understanding of the entity's risk assessment process in accordance with paragraph 29, and if applicable, paragraph 30, the auditor shall: (Ref: Para. A120-A121)
- (a) Evaluate whether the nature of the entity's risk assessment process, including its formality, is appropriate to the entity's circumstances considering the nature and size of the entity; and
  - (b) If not, determine whether the lack of an appropriate risk assessment process represents one or more control deficiencies.

The entity's process to monitor the system of internal control (Ref: Para. A122-A125)

32. The auditor shall obtain an understanding of the entity's process to monitor the system of internal control, including the extent to which it is formalised, by understanding how the entity's process: (Ref: Para. A126-A128)
- (a) Monitors the effectiveness of controls; and
  - (b) Addresses the identification and remediation of control deficiencies, including those related to the entity's risk assessment process.
33. The auditor shall obtain an understanding of the sources of the information used in the entity's process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose. (Ref: Para. A129-A130)
34. If the entity has an internal audit function,<sup>15</sup> the auditor shall obtain an understanding of the nature of the internal audit function's responsibilities, its organisational status, and the activities performed, or to be performed. (Ref: Para. A131-A135)

The Information System and Communication

35. The auditor shall obtain an understanding of the information system relevant to financial reporting, including the related business processes, through understanding: (Ref: Para. A136-A141)
- (a) How information relating to significant classes of transactions, account balances and disclosures flows through the entity's information system, whether manually or using IT, and whether obtained from within or outside of the general ledger and subsidiary ledgers. This understanding shall include how: (Ref: Para. A142-A143)
    - (i) Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, and incorporated in the general ledger and reported in the financial report; and
    - (ii) Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial report.
  - (b) The accounting records, specific accounts in the financial report and other supporting records relating to the flows of information in paragraph 35(a);
  - (c) The financial reporting process used to prepare the entity's financial report from the records described in paragraph 35(b), including as it relates to disclosures and to accounting estimates relating to significant classes of transactions, account balances and disclosures;

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<sup>15</sup> See ASA 610 *Using the Work of Internal Auditors*, paragraph 14(a), defines the term "internal audit function" for purposes of the ASA.

**Proposed Auditing Standard ASA 315**  
***Identifying and Assessing the Risks of Material Misstatement***

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- (d) The entity's IT environment relevant to (a) through (c) above. (Ref: Para. A144-A150 and Para. A180-A182)
- 36. The auditor shall evaluate the design of the information system controls relevant to financial reporting, by understanding how the matters in paragraph 35(a)–(d) are addressed by the entity, and implemented. (Ref: Para. A151-A157)
- 37. The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities and significant matters relevant to financial reporting, including: (Ref: Para. A158-A159)
  - (a) Communications between management and those charged with governance; and
  - (b) External communications, such as those with regulatory authorities.

**Control Activities**

- 38. The auditor shall obtain an understanding of the control activities component by identifying the controls relevant to the audit in the control activities component in accordance with the requirements of paragraphs 39 through 41, and by evaluating their design and determining whether they have been implemented in accordance with paragraph 42. (Ref: Para. A160-A165)

**Controls relevant to the audit**

- 39. The auditor shall identify controls relevant to the audit, being those: (Ref: Para. A166-A167)
  - (a) That address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; (Ref: Para. A168)
  - (b) That address risks that are identified as a significant risk; (Ref: Para. A169-A173)
  - (c) Over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments; (Ref: Para. A174-A175)
  - (d) Controls for which the auditor plans to test the operating effectiveness in determining the nature, timing and extent of substantive testing; or (Ref: Para. A176-A178)
  - (e) That, in the auditor's professional judgement, are appropriate to evaluate their design and determine whether they have been implemented to enable the auditor to: (Ref: Para. A179)
    - (i) Identify and assess the risks of material misstatement at the assertion level; or
    - (ii) Design further audit procedures responsive to assessed risks.

Not all controls that are relevant to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgement as to whether a control, individually or in combination with other controls, is identified as being relevant to the audit.

- 40. Based on the understanding obtained in accordance with paragraph 35(d), and the identification of the controls relevant to the audit in accordance with paragraph 39, the auditor shall identify the IT applications and the other aspects of the entity's IT environment that are relevant to the audit. In doing so, the auditor shall take into account whether the IT applications include or address: (Ref: Para. A180-A188)
  - (a) Automated controls that management is relying on and that the auditor has determined to be relevant to the audit;

- (b) Maintenance of the integrity of information stored and processed in the information system that relates to significant classes of transactions, account balances or disclosures;
  - (c) System-generated reports on which the auditor intends to rely on without directly testing the inputs and outputs of such reports; or
  - (d) Controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.
41. For the IT applications and other aspects of the IT environment that are relevant to the audit, the auditor shall identify: (Ref: Para. A189-A193)
- (a) The risks arising from the use of IT; and
  - (b) The general IT controls relevant to the audit.
42. For each control identified as relevant to the audit in accordance with paragraphs 39 and 41, the auditor shall: (Ref: Para. A194-A200)
- (a) Evaluate whether the control is designed effectively to address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls; and
  - (b) Determine whether the control has been implemented by performing procedures in addition to enquiry of the entity's personnel.

**Control Deficiencies Within the System of Internal Control**

43. The auditor shall, in accordance with ASA 265,<sup>16</sup> determine on the basis of the work performed in accordance with this ASA:
- (a) Whether one or more control deficiencies within the system of internal control have been identified; and
  - (b) If so, whether the control deficiencies, individually or in combination, constitute significant control deficiencies.
44. The auditor shall consider the implications for the audit of one or more control deficiencies in the system of internal control, including for:
- (a) The assessment of control risk for risks of material misstatement at the assertion level in accordance with paragraph 50; and
  - (b) Designing and implementing overall responses to address the assessed risks of material misstatement as required by ASA 330.<sup>17</sup>

**Identifying and Assessing the Risks of Material Misstatement**

45. The auditor shall identify the risks of material misstatement and determine whether they exist at: (Ref: Para. A201-A210)
- (a) The financial statement level, by evaluating whether the identified risks relate more pervasively to the financial report as a whole, including potentially affecting many assertions; or (Ref: Para. A207)

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<sup>16</sup> See ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraphs 7-8.

<sup>17</sup> See ASA 330 *The Auditor's Responses to Assessed Risks*, paragraph 5.

**Proposed Auditing Standard ASA 315**  
***Identifying and Assessing the Risks of Material Misstatement***

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- (b) The assertion level for classes of transactions, account balances, and disclosures, taking into account the inherent risk factors. (Ref: Para. A208)
- 46. The auditor shall determine significant classes of transactions, account balances and disclosures, and their relevant assertions, based on the identified risks of material misstatement. (Ref: Para. A211-A214)

*Assessing Risks of Material Misstatement at the Financial Statement Level*

- 47. The auditor shall assess the identified risks of material misstatement at the financial statement level by: (Ref: Para. A215-A220)
  - (a) Determining how, and the degree to which, such risks affect the assessment of risks of material misstatement at the assertion level (Ref: Para. A227), and
  - (b) Evaluating the nature and extent of their pervasive effect on the financial report to provide the basis for designing and implementing overall responses to the identified risk of material misstatement at the financial statement level in accordance with ASA 330.<sup>18</sup> (Ref: Para A216)

*Assessing Risks of Material Misstatement at the Assertion Level*

*Assessing Inherent Risk*

- 48. For identified risks of material misstatement at the assertion level, the auditor shall assess inherent risk by assessing the likelihood and magnitude of material misstatement. In doing so, the auditor shall take into account how, and the degree to which:
  - (a) Identified events and conditions relating to significant classes of transactions, account balances and disclosures are subject to, or affected by, the inherent risk factors. (Ref: Para. A221-A228)
  - (b) The risks of material misstatement at the financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level. (Ref: Para. A216 and A227)
- 49. The auditor shall determine, based on the auditor's assessment of inherent risk, whether any of the assessed risks of material misstatement are significant risks. (Ref: Para. A229-A231)

*Assessing Control Risk*

- 50. For identified risks of material misstatement at the assertion level, the auditor shall assess control risk as follows: (Ref: Para. A232-A235)
  - (a) When the auditor plans to test the operating effectiveness of controls in designing further audit procedures to be performed to respond to a risk of material misstatement at the assertion level, the auditor shall assess control risk at less than maximum. In doing so, the auditor shall take into account whether the design, implementation and expected operating effectiveness of such controls support the auditor's intended reliance thereon.
  - (b) When the auditor does not plan to test the operating effectiveness of controls in designing further audit procedures to be performed to respond to a risk of material misstatement at the assertion level, the auditor shall assess control risk at the maximum.

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<sup>18</sup> See ASA 330, paragraph 5.

**Proposed Auditing Standard ASA 315**  
***Identifying and Assessing the Risks of Material Misstatement***

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*Risks for Which Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence*

51. The auditor shall determine, for any of the risks of material misstatement at the assertion level, whether substantive procedures alone cannot provide sufficient appropriate audit evidence (Ref: Para. A236-A239)

*Classes of Transactions, Account Balances and Disclosures that are Not Significant, but which are Material*

52. The auditor shall: (Ref: Para. A240-A242)
- (a) Identify the classes of transactions, account balances and disclosures that are quantitatively or qualitatively material, and that have not been identified as significant classes of transactions, account balances or disclosures in accordance with paragraph 46; and
  - (b) Evaluate whether the auditor's conclusion that there are no relevant assertions (that is, no related risks of material misstatement) for these classes of transactions, account balances and disclosures remains appropriate.

*Revision of Risk Assessment*

53. The auditor's assessments of the risks of material misstatement at the financial statement level and assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the identification and assessments of the risks of material misstatement, the auditor shall revise the assessment and modify the planned overall responses or further audit procedures accordingly. (Ref: Para. A243)

**Documentation**

54. The auditor shall include in the audit documentation:<sup>19</sup> (Ref: Para. A244-A247)
- (a) The discussion among the engagement team, where required in accordance with paragraph 22, and the significant decisions reached;
  - (b) Key aspects of the auditor's understanding obtained regarding the entity and its environment specified in paragraph 23 and of each of the components of the system of internal control specified in paragraphs 27, 29, 32 through 38; the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed;
  - (c) The controls identified to be relevant to the audit in accordance with the requirements in paragraphs 39 and 41.
  - (d) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level as required by paragraph 45 through 51, including significant risks, and the rationale for the significant judgements made in identifying and assessing the risks of material misstatement. (Ref: Para A245)

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<sup>19</sup> See ASA 230 *Audit Documentation*, paragraphs 8-11 and A6-A7.

## **Application and Other Explanatory Material**

### **Definitions**

*Assertions* (Ref: Para. 16(b))

- A1. Representations by management with respect to the recognition, measurement, presentation and disclosure of information in the financial report of classes of transactions, account balances and disclosures differ from written representations provided to the auditor by management, as required by ASA 580,<sup>20</sup> to confirm certain matters or support other audit evidence.
- A2. Assertions that the auditor may use in addressing the requirements of this ASA are further described in paragraph A204.

*Controls* (Ref: Para. 16(d))

- A3. Policies are implemented through the actions of personnel within the entity, or through their restraint from taking actions that would conflict with such policies.
- A4. Procedures may be mandated, through formal documentation or other communication by management or those charged with governance, or may result from behaviours that are not mandated but are rather conditioned by the entity's culture. Procedures may be enforced through the actions permitted by the IT applications used by the entity or other aspects of the entity's IT environment.

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

- A5. Inherent risk factors may be qualitative or quantitative and affect the susceptibility to misstatement of financial statement items. Qualitative inherent risk factors relating to the preparation of information required by the applicable financial reporting framework (referred to in this paragraph as "required information") include:
- *Complexity*—arises either from the nature of the information or in the way that the required information is prepared, including when such preparation processes are more inherently difficult to apply. For example, complexity may arise:
    - In calculating supplier rebate provisions because it may be necessary to take into account different commercial terms with many different suppliers, or many interrelated commercial terms that are all relevant in calculating the rebates due; or
    - When there are many potential data sources, with different characteristics used in making an accounting estimate, the processing of that data involves many inter-related steps, and the data is therefore inherently more difficult to identify, capture, access, understand or process.
  - *Subjectivity*—arises from inherent limitations in the ability to prepare required information in an objective manner, due to limitations in the availability of knowledge or information, such that management may need to make an election or subjective judgement about the appropriate approach to take and about the resulting information to include in the financial report. Because of different approaches to preparing the required information, different outcomes could result from appropriately applying the requirements of the applicable financial reporting framework. As limitations in knowledge or data increase, the subjectivity in the judgements that could be made by

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<sup>20</sup> See ASA 580 *Written Representations*.

reasonably knowledgeable and independent individuals, and the diversity in possible outcomes of those judgements will also increase.

- *Change*—results from events or conditions that, over time, affect the entity’s business or the economic, accounting, regulatory, industry or other aspects of the environment in which it operates, when the effects of those events or conditions are reflected in the required information. Such events or conditions may occur during, or between, financial reporting periods. For example, change may result from developments in the requirements of the applicable financial reporting framework, or in the entity and its business model, or in the environment in which the entity operates. Such change may affect management’s assumptions and judgements, including as they relate to management’s selection of accounting policies or how accounting estimates are made or related disclosures are determined.
- *Uncertainty*—arises when the required information cannot be prepared based only on sufficiently precise and comprehensive data that is verifiable through direct observation. In these circumstances, an approach may need to be taken that applies the best available knowledge to prepare the information using sufficiently precise and comprehensive observable data, to the extent available, and reasonable assumptions supported by the best available data, when it is not. Constraints on the availability of knowledge or data, which are not within the control of management (subject to cost constraints where applicable) are sources of uncertainty and their effect on the preparation of the required information cannot be eliminated. For example, estimation uncertainty arises when the required monetary amount cannot be determined with precision and the outcome of the estimate is not known before the date the financial report is finalised.
- *Susceptibility to misstatement due to management bias or fraud*— results from conditions that create susceptibility to intentional or unintentional failure by management to maintain neutrality in preparing the information. Management bias is often associated with certain conditions that have the potential to give rise to management not maintaining neutrality in exercising judgement (indicators of potential management bias), which could lead to a material misstatement of the information that would be fraudulent if intentional. Such indicators include inherent incentives or pressures (for example, as a result of motivation to achieve a desired result, such as a desired profit target or capital ratio), and opportunity, not to maintain neutrality. Factors relevant to the susceptibility to misstatement due to fraud for assertions about classes of transactions, account balances and disclosures are described in paragraphs A1 to A5 of ASA 240.

A6. Other inherent risk factors, that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure include:

- The quantitative or qualitative significance of the class of transactions, account balance or disclosure, and of the items in relation to performance materiality;
- The composition of the class of transactions, account balance or disclosure, including whether the items are subject to differing risks;
- The volume of activity and homogeneity of the individual transactions processed through the class of transactions or account balance or class of transactions, or reflected in the disclosure; or
- The existence of related party transactions in the class of transaction or account balance, or that are relevant to the disclosure.



*IT Environment* (Ref: Para 16(g))

- A7. IT applications may include data warehouses or report writers. A data warehouse is a central repository of integrated data from one or more disparate sources (such as multiple databases) from which reports may be generated or that may be used by the entity for other data analysis activities. A report-writer is an IT application that is used to extract data from one or more sources (such as a data warehouse, a database or an IT application) and present the data in a specified format.
- A8. A network is used in the IT infrastructure to transmit data and to share information, resources and services through a common communications link. The network also typically establishes a layer of logical security (enabled through the operating system) for access to the underlying resources. The operating system is responsible for managing communications between hardware, IT applications, and other software used in the network. Databases store the data used by IT applications and may consist of many interrelated data tables. Data in databases may also be accessed directly through database management systems by IT or other personnel with database administration privileges.

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

- A9. There will be one or more risks of material misstatement that relate to a relevant assertion. A risk of material misstatement may relate to more than one assertion, in which case all the assertions to which such a risk relates would be relevant assertions

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

- A10. Significance can be described as the relative importance of a matter, taken in context. The significance of a matter is judged by the auditor in the context in which the matter is being considered. The significance of a risk of material misstatement at the assertion level is considered in the context of the implications of the assessment of its inherent risk for the performance of the audit, including the nature, timing and extent of the auditor's further audit procedures and the persuasiveness of the audit evidence that will be required to reduce audit risk to an acceptable level. Significance can be considered in the context of how, and the degree to which, the susceptibility to misstatement is subject to, or affected by, the inherent risk factors, which affect the likelihood that a misstatement will occur, as well as the potential magnitude of the misstatement were that misstatement to occur.

*System of Internal Control* (Ref: Para. 16(l))

- A11. The entity's system of internal control may be reflected in policy and procedures manuals, systems and forms, and the information embedded therein, and is effected by people. The system of internal control is implemented by management, those charged with governance, and other personnel based on the structure of the entity. The system of internal control can be applied, based on the decisions of management, those charged with governance and other personnel and in the context of legal or regulatory requirements, to the operating model of the entity, the legal entity structure, or a combination of these.

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

*Risk Assessment Procedures* (Ref: Para. 17)

- A12. Obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control is a dynamic and iterative process of gathering, updating and analysing information and continues throughout the audit. As the auditor performs audit procedures, the audit evidence obtained may cause the auditor to update the understanding on which the risk assessment was based and the nature, timing or extent of other planned audit procedures in accordance with ASA 330. For example, information gathered in understanding the entity's system of internal control assists the auditor in assessing control risk at the assertion level, such that control risk may be assessed at less

than maximum based on an expectation about the operating effectiveness of the control(s) and the planned testing of such control(s). Information gathered when testing the operation of the control(s) as part of performing further audit procedures may indicate that the control(s) are not effective, and as a result the auditor's original assessment is updated in accordance with paragraph 53.

- A13. The risks of material misstatement to be identified and assessed include both those due to fraud and those due to error, and both are covered by this ASA. However, the significance of fraud is such that further requirements and guidance are included in ASA 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify the risks of material misstatement due to fraud.<sup>21</sup> In addition, the following Australian Auditing Standards provide further requirements and guidance on identifying and assessing risks of material misstatement in regard to specific matters or circumstances:
- ASA 540<sup>22</sup> in regard to accounting estimates;
  - ASA 550<sup>23</sup> in regard to related party relationships and transactions;
  - ASA 570<sup>24</sup> in regard to going concern; and
  - ASA 600<sup>25</sup> in regard to group financial report.
- A14. The understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control also establishes a frame of reference within which the auditor plans the audit and exercises professional judgement throughout the audit, for example, when:
- Identifying and assessing risks of material misstatement of the financial report (e.g., relating to risks of fraud in accordance with ASA 240 or when identifying or assessing risks related to accounting estimates in accordance with ASA 540);
  - Determining materiality or performance materiality in accordance with ASA 320;<sup>26</sup>
  - Considering the appropriateness of the selection and application of accounting policies, and the adequacy of financial statement disclosures;
  - Developing expectations for use when performing analytical procedures in accordance with ASA 520;<sup>27</sup>
  - Responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence in accordance with ASA 330;<sup>28</sup> and
  - Evaluating the sufficiency and appropriateness of audit evidence obtained (e.g., relating to assumptions or management's oral and written representations).
- A15. Information obtained by performing risk assessment procedures and related activities in accordance with paragraphs 17 to 22 of this ASA is audit evidence that supports the identification and assessment of the risks of material misstatement. In addition, the auditor may obtain some audit evidence about classes of transactions, account balances, or disclosures, and related assertions, and about the operating effectiveness of controls, even

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<sup>21</sup> See ASA 240, paragraphs 12-24.

<sup>22</sup> See ASA 540 *Auditing Accounting Estimates and Related Disclosures*.

<sup>23</sup> See ASA 550 *Related Parties*.

<sup>24</sup> See ASA 570 *Going Concern*.

<sup>25</sup> See ASA 600 *Special Considerations – Audits of a Group Financial Report*.

<sup>26</sup> See ASA 320 *Materiality in Planning and Performing an Audit*, paragraphs 10-11.

<sup>27</sup> See ASA 520 *Analytical Procedures*, paragraph 5.

<sup>28</sup> See ASA 330 *The Auditor's Responses to Assessed Risks*.

though such risk assessment procedures were not specifically planned as substantive procedures or as tests of controls. The auditor may also perform designed substantive procedures or tests of controls concurrently with risk assessment procedures because it is efficient to do so. For example, through the use of technology the auditor may perform procedures on large volumes of data, and audit evidence may be obtained that provides information that is useful for the identification and assessment of risks of material misstatement, as well as providing sufficient appropriate audit evidence to support the conclusion that the possibility of a material misstatement is remote.

- A16. The auditor uses professional judgement to determine the nature and extent of the required understanding. The auditor's primary consideration is whether the understanding that has been obtained meets the objective stated in this ASA. The auditor's risk assessment procedures to obtain the overall understanding may be less extensive in audits of smaller and less complex entities. The depth of the overall understanding that is required by the auditor is less than that possessed by management in managing the entity.

*Types of Risk Assessment Procedures and Sources of Information* (Ref: Para. 18)

- A17. ASA 500<sup>29</sup> explains the types of audit procedures that may be performed in obtaining audit evidence from risk assessment procedures and further audit procedures. The nature and timing of the audit procedures may be affected by the fact that some of the accounting data and other information may only be available in electronic form or only at certain points in time.<sup>30</sup>
- A18. Some of the information used by the auditor when performing risk assessment procedures may be electronic data available from the entity's information system, for example the general ledger, sub-ledgers or other operational data. In performing risk assessment procedures, the auditor may use automated tools and techniques in performing the risk assessment procedures, including for analysis, recalculations, reperformance or reconciliations.
- A19. Sources of information available to the auditor may include:
- Information obtained through interactions with management, those charged with governance, and other key entity personnel, such as internal auditors.
  - Information obtained directly or indirectly from certain external parties such as regulators.
  - Information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, updated as appropriate.
  - Publicly available information about the entity, for example entity-issued press releases, and materials for analysts or investor group meetings, analysts' reports or information about trading activity.

These sources may provide potentially contradictory information, which may assist the auditor in exercising professional scepticism in identifying and assessing the risks of material misstatement. Regardless of the source of information, the auditor considers the relevance and reliability of the information to be used as audit evidence in accordance with ASA 500.<sup>31</sup>

- A20. Although the auditor is required to perform all the risk assessment procedures described in paragraph 18 in the course of obtaining the required understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control (see paragraphs 23–44), the auditor is not required to perform all of them for each aspect of that understanding. Other procedures may be performed where the information to be obtained therefrom may be helpful in identifying risks of material misstatement. Examples of

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<sup>29</sup> See ASA 500 *Audit Evidence*, paragraphs A14-A17 and A21-A25.

<sup>30</sup> See ASA 500, paragraph A12.

<sup>31</sup> See ASA 500, paragraph 7.

such procedures may include making enquiries of the entity's external legal counsel or external supervisors, or of valuation experts that the entity has used.

*Enquiries of Management, the Internal Audit Function and Others within the Entity* (Ref: Para. 18(a))

- A21. Much of the information obtained by the auditor's enquiries is obtained from management and those responsible for financial reporting. Information may also be obtained by the auditor through enquiries of the internal audit function, if the entity has such a function, and others within the entity.
- A22. The auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through enquiries of others within the entity and other employees with different levels of authority. For example:
- Enquiries directed towards those charged with governance may help the auditor understand the environment in which the financial report is prepared. ASA 260<sup>32</sup> identifies the importance of effective two-way communication in assisting the auditor to obtain information from those charged with governance in this regard.
  - Enquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
  - Enquiries directed towards in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contractual terms.
  - Enquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
  - Enquiries directed towards the risk management function (or those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
  - Enquiries directed towards information system personnel may provide information about system changes, system or control failures, or other information system-related risks.
- A23. As obtaining an understanding of the entity and its environment is a continual, dynamic process, the auditor's enquiries may occur throughout the audit engagement.

#### Considerations Specific to Public Sector Entities

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

#### Enquiries of the Internal Audit Function

- A25. If an entity has an internal audit function, enquiries of the appropriate individuals within the function may provide information that is useful to the auditor in obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, and in identifying and assessing risks of material misstatement at

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<sup>32</sup> See ASA 260 *Communication with Those Charged with Governance*, paragraph 4(b).

the financial statement and assertion levels. In performing its work, the internal audit function is likely to have obtained insight into the entity's operations and business risks, and may have findings based on its work, such as identified control deficiencies or risks, that may provide valuable input into the auditor's understanding of the entity and its environment, the applicable financial reporting framework and the system of internal control, the auditor's risk assessments or other aspects of the audit. The auditor's enquiries are therefore made whether or not the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed.<sup>33</sup> Enquiries of particular relevance may be about matters the internal audit function has raised with those charged with governance and the outcomes of the function's own risk assessment process.

- A26. If, based on responses to the auditor's enquiries, it appears that there are findings that may be relevant to the entity's financial reporting and the audit, the auditor may consider it appropriate to read related reports of the internal audit function. Examples of reports of the internal audit function that may be relevant include the function's strategy and planning documents and reports that have been prepared for management or those charged with governance describing the findings of the internal audit function's examinations.
- A27. In addition, in accordance with ASA 240,<sup>34</sup> if the internal audit function provides information to the auditor regarding any actual, suspected or alleged fraud, the auditor takes this into account in the auditor's identification of risk of material misstatement due to fraud.
- A28. Appropriate individuals within the internal audit function with whom enquiries are made are those who, in the auditor's judgement, have the appropriate knowledge, experience and authority, such as the chief internal audit executive or, depending on the circumstances, other personnel within the function. The auditor may also consider it appropriate to have periodic meetings with these individuals.

Considerations specific to public sector entities

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

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

- A30. Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in identifying and assessing the risks of material misstatement. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold.
- A31. Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.
- A32. Analytical procedures performed as risk assessment procedures may use data aggregated at a high level and accordingly the results of those analytical procedures may provide a broad initial indication about the likelihood of a material misstatement. For example, in the audit of many entities, including those with less complex business models and processes, and a less complex information system, the auditor may perform a simple comparison of information,

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<sup>33</sup> The relevant requirements are contained in ASA 610.

<sup>34</sup> See ASA 240, paragraph 19.

such as the change in account balances from interim or monthly reporting with balances from prior periods, to obtain an indication of potentially higher risk areas.

- A33. Analytical procedures can be performed using a number of tools or techniques, which may be automated. Applying automated analytical procedures to the data may be referred to as data analytics. For example, the auditor may use a spreadsheet to perform a comparison of actual recorded amounts to budgeted amounts, or may perform a more advanced procedure by extracting data from the entity's information system, and further analysing this data using visualization techniques to identify more specific areas of possible misstatement.
- A34. This ASA deals with the auditor's use of analytical procedures as risk assessment procedures. ASA 520 deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"). Accordingly, analytical procedures performed as risk assessment procedures are not required to be performed in accordance with the requirements of ASA 520. However, the requirements and application material in ASA 520 may provide useful guidance to the auditor when performing analytical procedures as part of the risk assessment procedures.

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

- A35. Observation and inspection may support enquiries of management and others, and may also provide information about the entity and its environment. Examples of such risk assessment procedures include observation or inspection of the following:
- The entity's operations.
  - Internal documents (such as business plans and strategies), records, and internal control manuals.
  - Reports prepared by management (such as quarterly management reports and interim financial report) and those charged with governance (such as minutes of board of directors' meetings).
  - The entity's premises and plant facilities.
  - Information obtained from external sources such as trade and economic journals; reports by analysts, banks, or rating agencies; or regulatory or financial publications; or other external documents about the entity's financial performance (such as those referred to in paragraph A74).
  - The behaviours and actions of management or those charged with governance (such as the observation of an audit committee meeting).

*Considerations specific to public sector entities*

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

*Information from the Acceptance or Continuance of the Client Relationship or the Audit Engagement*  
(Ref: Para. 19)

- A37. In accordance with ASA 220, the engagement partner is required to be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed, and to determine that conclusions reached in this regard are appropriate.<sup>35</sup> Information obtained in the client and engagement acceptance or

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<sup>35</sup> See ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*, paragraph 12.

continuance process may be relevant to the identification and assessment of the risks of material misstatement. Examples may include:

- Information about the nature of the entity and its business risks.
- Information about the integrity and ethical values of management and those charged with governance, which may be relevant to the auditor's understanding of the control environment, and may also affect the auditor's identification and assessment of the risks of material misstatement at the financial statement level.
- The applicable financial reporting framework and information about its application to the nature and circumstances of the entity.

*Information from Other Engagements Performed for the Entity* (Ref: Para. 20)

- A38. The engagement partner may have performed other engagements for the entity and may thereby have obtained knowledge relevant to the audit, including about the entity and its environment. Such engagements may include agreed-upon procedures engagements (e.g., agreed-upon procedures relating to an entity's debt covenant compliance) or other audit or assurance engagements (e.g., audits of special purpose financial report or reviews of interim financial information).

*Information Obtained in Prior Periods* (Ref: Para. 21)

- A39. The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about such matters as:
- Past misstatements and whether they were corrected on a timely basis.
  - The nature of the entity and its environment, and the entity's system of internal control (including control deficiencies).
  - Significant changes that the entity or its operations may have undergone since the prior financial period, which may assist the auditor in gaining a sufficient understanding of the entity to identify and assess risks of material misstatement.
  - Those particular types of transactions and other events or account balances (and related disclosures) where the auditor experienced difficulty in performing the necessary audit procedures, for example, due to their complexity.
- A40. The auditor is required to determine whether information obtained in prior periods remains relevant and reliable, if the auditor intends to use that information for the purposes of the current audit. This is because changes in the entity's system of internal control, for example, may affect the relevance and reliability of information obtained in the prior period. In evaluating whether such information remains relevant and reliable for the current audit, the auditor may consider whether changes have occurred that may affect the relevance or reliability of such information. For example, the auditor may make enquiries and perform other appropriate audit procedures, such as walk-throughs of relevant systems.

*Discussion Among the Engagement Team* (Ref: Para. 22)

- A41. Paragraph 22 requires the engagement partner and other key engagement team members to discuss the application of the applicable financial reporting framework in the context of the nature and circumstances of the entity and its environment, and the susceptibility of the entity's financial report to material misstatement. When the engagement is carried out by a single individual (such as a sole practitioner) i.e., where an engagement team discussion would not be possible, consideration of the matters referred to in paragraphs A42 and A43 nonetheless may assist the auditor in identifying where there may be risks of material misstatement.

A42. The discussion among the engagement team about the susceptibility of the entity's financial report to material misstatement:

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

ASA 240 requires the engagement team discussion to place particular emphasis on how and where the entity's financial report may be susceptible to material misstatement due to fraud, including how fraud may occur.<sup>36</sup>

A43. As part of the discussion among the engagement team required by paragraph 22, consideration of the disclosure requirements of the applicable financial reporting framework assists in identifying early in the audit where there may be risks of material misstatement in relation to disclosures, even in circumstances where the applicable financial reporting framework only requires simplified disclosures. Examples of matters the engagement team may discuss include:

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

A44. In addition to the intended benefits of the engagement team discussion included in paragraph A42, the engagement team may also have an opportunity to exercise professional scepticism while performing risk assessment procedures, such as through identifying and discussing contradictory information obtained in performing those procedures, as well as in considering whether there are indicators of possible management bias (both intentional and unintentional). Professional scepticism is necessary for the critical assessment of audit evidence, and a robust and open engagement team discussion, including for recurring audits,

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<sup>36</sup> See ASA 240, paragraph 15.



may lead to improved identification and assessment of the risks of material misstatement. Another outcome from the discussion may be that the auditor identifies specific areas of the audit for which exercising professional scepticism may be particularly important, which may in turn drive the consideration of those engagement team members who are appropriately skilled to be involved in the performance of audit procedures related to those areas.

- A45. It is not always necessary or practical for the discussion to include all members in a single discussion (as, for example, in a multi-location audit), nor is it necessary for all of the members of the engagement team to be informed of all of the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team including, if considered appropriate, those with specific skills or knowledge, and those responsible for the audits of components, while delegating discussion with others, while taking into account of the extent of communication considered necessary throughout the engagement team. A communications plan, agreed by the engagement partner, may be useful.

#### Considerations Specific to Public Sector Entities

- A46. As part of the discussion among the engagement team, as required by paragraph 22, by auditors of public sector entities, consideration may also be given to any additional broader objectives, and related risks, arising from the audit mandate or obligations for public sector entities.

#### **Obtaining an Understanding of the Entity and Its Environment and the Applicable Financial Reporting Framework** (Ref: Para. 23-24)

- A47. The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, establishes a frame of reference within which the auditor identifies and assesses risks of material misstatement, and plans and performs audit procedures. Specifically, the auditor applies professional judgement in determining whether the understanding required by paragraph 23 is sufficient to provide an appropriate basis for the auditor to understand the classes of transactions, account balances and disclosures to be expected in the entity's financial report. This understanding assists the auditor in identifying areas in the financial report where material misstatements may be more likely to arise and assists the auditor in exercising professional scepticism throughout the audit. The nature and extent of the understanding required will likely depend on the nature, size and complexity of the entity.

#### *The Entity and Its Environment* (Ref: Para 23(a))

- A48. In obtaining an understanding of the entity and its environment, the auditor may be able to enhance the understanding by using automated tools and techniques. For example, the auditor may use automated techniques to understand flows of transactions and processing as part of the auditor's procedures to understand the information system. An outcome of these procedures may be that the auditor obtains information about the entity's organisational structure or those with whom the entity conducts business (e.g., vendors, customers, related parties).

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

##### The entity's organisational structure and ownership

- A49. An understanding of the entity's organisational structure and ownership may enable the auditor to understand such matters as:
- The complexity of the entity's structure. For example, the entity may be a single entity or the entity's structure may include subsidiaries, divisions or other components in multiple locations. Further, the legal structure may be different from the operating structure. Complex structures often introduce factors that may give rise to increased

susceptibility to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or special-purpose entities are accounted for appropriately and whether adequate disclosure of such issues in the financial report have been made.

- The ownership, and relationships between owners and other people or entities, including related parties. This understanding may assist in determining whether related party transactions have been appropriately identified, accounted for, and adequately disclosed in the financial report.<sup>37</sup>
- The distinction between the owners, those charged with governance and management. In some entities, particularly smaller and less complex entities, owners of the entity may be involved in managing the entity, or those charged with governance may be involved in managing the entity.<sup>38</sup>
- The entity's IT environment. For example, an entity's IT environment may be relatively simple because it consists only of commercial software for which the entity does not have access to the underlying source code to which no changes have been made. Alternatively, an entity may have grown through extensive merger and acquisition activity and have multiple legacy IT systems in diverse businesses that are not well integrated resulting in a complex IT environment.

#### Considerations specific to public sector entities

- A50. In obtaining an understanding of the entity's organisational structure and ownership, auditors of public sector entities may consider the relevance of ownership of a public sector entity (i.e., ownership of a public sector entity may not have the same relevance as in the private sector because decisions related to the entity may be initiated outside of the entity as a result of political processes and therefore management may not have control over decisions that are made). Matters related to the understanding of the organisational structure, governance and business model of a public sector entity may include understanding the ability of the entity to make unilateral decisions, and the ability of other public sector entities to control or influence the entity mandate and strategic direction. For example, the public sector entity may be subject to laws or other directives from authorities that require it to obtain approval from parties external to the entity of its strategy and objectives prior to it implementing them. Matters related to understanding the legal structure of the entity may include applicable laws and regulations, and the classification of the entity (i.e. whether the entity is a ministry, department, agency or other type of entity).

#### Governance

- A51. Responsibilities of management and those charged with governance are broader than responsibilities for the oversight of the system of internal control, but are generally prerequisites for an effective system of internal control. The responsibilities of those charged with governance in relation to the control environment are further discussed in Appendix 3. Deficient governance processes may limit an entity's ability to provide appropriate oversight of its system of internal control, which may increase the entity's susceptibility to risks of material misstatement. Matters that may be relevant for the auditor to consider in obtaining an understanding of the governance of the entity include:
- Whether any or all of those charged with governance are involved in managing the entity.

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<sup>37</sup> ASA 550 establishes requirements and provide guidance on the auditor's considerations relevant to related parties.

<sup>38</sup> ASA 260, paragraphs A1 and A2, provides guidance on the identification of those charged with governance and explains that in some cases, some or all of those charged with governance are involved in managing the entity.

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

#### The Entity's Business Model

- A52. The auditor's understanding of the entity's business model, and how it is affected by its business strategy and business objectives, may assist the auditor in identifying business risks that are relevant in the context of the audit. Furthermore, this may assist the auditor in identifying risks of material misstatement. For example, incentives and pressures on management may result in intentional or unintentional management bias, which may affect the reasonableness of significant assumptions and expectations of management or those charged with governance thereby increasing the susceptibility to risks of material misstatement. (See also paragraph A59).
- A53. An entity's business model describes how an entity considers, for example its organisational structure, operations or scope of activities, business lines (including competitors and customers thereof), processes, growth opportunities, globalization, regulatory requirements and technologies. The entity's business model describes how the entity creates, preserves and captures financial or broader value, such as public benefits, for its stakeholders.
- A54. Strategies are the approaches by which management plans to achieve the entity's objectives, including how the entity plans to address the risks and opportunities that it faces. An entity's strategies are changed over time by management, to respond to changes in its objectives and in the internal and external circumstances in which it operates.
- A55. A description of a business model typically includes:
- The scope of the entity's activities, and why it does them.
  - The entity's structure and scale of its operations.
  - The markets or geographical or demographic spheres, and parts of the value chain, in which it operates, how it engages with those markets or spheres (main products, customer segments and distribution methods), and the basis on which it competes.
  - The entity's business or operating processes (e.g., investment, financing and operating processes) employed in performing its activities, focusing on those parts of the business processes that are important in creating, preserving or capturing value.
  - The resources (e.g., financial, human, intellectual, environmental and technological) and other inputs and relationships (e.g., customers, competitors, suppliers and employees) that are necessary or important to its success.
  - How the entity's business model integrates the use of IT in its interactions with customers, suppliers, lenders and other stakeholders through IT interfaces and other technologies.
- A56. Understanding the entity's objectives, strategy and business model helps the auditor to understand the entity at a strategic level and to understand the business risks the entity takes and faces. Not all aspects of the business model are relevant for the auditor's understanding,

but those aspects that give rise to business risks, which are relevant to the identification and assessment of risks of material misstatement, are likely to be more relevant for the auditor's understanding.

- A57. Appendix 1 provides examples of matters that may be considered when obtaining an understanding of the activities of the entity, as well as other matters that may be considered when auditing financial report of special purpose entities.

Considerations specific to public sector entities

- A58. Entities operating in the public sector may create and deliver value in different ways to those creating wealth for owners, but will still have a 'business model' to promote value in the public interest. Matters public sector auditors may obtain an understanding of that are relevant to the business model of the entity, include:

- Knowledge of relevant government activities, including related programs.
- Program objectives and strategies, including public policy elements.

Business risks in the context of the entity's business model

- A59. An understanding of the business risks that have an effect on the financial report assists the auditor in identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the financial report. Business risks are broader than the risks of material misstatement of the financial report, although business risks includes the latter. The auditor does not have a responsibility to identify or assess all business risks because not all business risks give rise to risks of material misstatement. Business risk may arise from, among other matters, inappropriate objectives or strategies, ineffective execution of strategies, or change or complexity. A failure to recognise the need for change may also give rise to business risk, for example, from:

- The development of new products or services that may fail;
- A market which, even if successfully developed, is inadequate to support a product or service; or
- Flaws in a product or service that may result in legal liability and reputational risk.

- A60. A business risk may have an immediate consequence for the risk of material misstatement for classes of transactions, account balances, and disclosures at the assertion level or the financial statement level. For example, the business risk arising from a significant fall in real estate market values may increase the risk of material misstatement associated with the valuation assertion for a lender of medium-term real estate backed loans. However, the same risk, particularly in combination with a severe economic downturn that concurrently increases the underlying risk of lifetime credit losses on its loans, may also have a longer-term consequence. The resulting net exposure to credit losses may cast significant doubt on the entity's ability to continue as a going concern. If so, this could have implications for management's and the auditor's conclusion as to the appropriateness of the entity's use of the going concern basis of accounting and determination as to whether a material uncertainty exists. Whether a business risk may result in a risk of material misstatement is, therefore, considered in light of the entity's circumstances. Examples of events and conditions that may indicate risks of material misstatement are indicated in Appendix 2.

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

- Industry developments (a potential related business risk might be, for example, that the entity does not have the personnel or expertise to deal with the changes in the industry).
- New products and services (a potential related business risk might be, for example, that there is increased product liability).
- Expansion of the business (a potential related business risk might be, for example, that the demand has not been accurately estimated).
- New accounting requirements (a potential related business risk might be, for example, incomplete or improper implementation, or increased costs).
- Regulatory requirements (a potential related business risk might be, for example, that there is increased legal exposure).
- Current and prospective financing requirements (a potential related business risk might be, for example, the loss of financing due to the entity's inability to meet requirements).
- Use of IT (a potential related business risk might be, for example, that the entity is implementing a new IT system that will affect both operations and financial reporting).
- The effects of implementing a strategy, particularly any effects that will lead to new accounting requirements (a potential related business risk might be, for example, incomplete or improper implementation).

A62. Ordinarily, management identifies business risks and develops approaches to address them. Such a risk assessment process is part of the entity's system of internal control and is discussed in paragraph 29–31 and paragraphs A115–A121.

#### Considerations Specific to Public Sector Entities

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

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

##### Industry factors

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

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

A65. The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of regulation. For example, long-term contracts may involve significant estimates of revenues and expenses that give rise

to risks of material misstatement. In such cases, it is important that the engagement team include members with sufficient relevant knowledge and experience.<sup>39</sup>

#### Regulatory Factors

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

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

A67. ASA 250 includes some specific requirements related to the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates.<sup>40</sup>

#### Considerations specific to public sector entities

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

#### Other External Factors

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

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

A70. Management and others ordinarily measure and review those matters they regard as important. The procedures undertaken to measure the relevant performance of the entity may vary depending on the size or complexity of the entity, as well as the involvement of owners or those charged with governance in the management of the entity.

A71. Performance measures, whether used externally or internally, may create pressures on the entity. These pressures, in turn, may motivate management to take action to improve the business performance or to intentionally misstate the financial report. Accordingly, an understanding of the entity's performance measures assists the auditor in considering whether pressures to achieve performance targets may result in management actions that increase the susceptibility to misstatement due to management bias or fraud. For example, the auditor may identify incentives or pressures that may increase the risk of management override of controls. See ASA 240 for requirements and guidance in relation to the risks of fraud.

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<sup>39</sup> See ASA 220, paragraph 14.

<sup>40</sup> See ASA 250 *Consideration of Laws and Regulations in an Audit of a Financial Report*, paragraph 13.

A72. The measurement and review of financial performance is not the same as the monitoring of the system of internal control (discussed as a component of the system of internal control in paragraphs A122–A135), though their purposes may overlap:

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

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

A73. Examples of internally-generated information used by management for measuring and reviewing financial performance, and which the auditor may consider, include:

- Key performance indicators (financial and non-financial) and key ratios, trends and operating statistics.
- Period-on-period financial performance analyses.
- Budgets, forecasts, variance analyses, segment information and divisional, departmental or other level performance reports.
- Employee performance measures and incentive compensation policies.
- Comparisons of an entity's performance with that of competitors.

A74. External parties may also review and analyse the entity's financial performance, in particular for entities where financial information is publicly available. For example, publicly available financial information may be issued by:

- Analysts or credit agencies.
- Revenue authorities.
- Regulators.
- Trade unions.
- Providers of finance.

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

A75. Internal measures may highlight unexpected results or trends requiring management to determine their cause and take corrective action (including, in some cases, the detection and correction of misstatements on a timely basis). Performance measures may also indicate to the auditor the likelihood with which risks of misstatement of related financial statement information exist. For example, performance measures may indicate that the entity has unusually rapid growth or profitability when compared to that of other entities in the same industry.

A76. Performance measures and targets, whether imposed internally or externally, particularly if combined with other factors such as performance-based bonus or incentive remuneration, may indicate an increased susceptibility to misstatement due to management bias or fraud in the preparation of the financial report.

A77. Enquiry of management may reveal that it relies on certain key indicators for evaluating financial performance and taking appropriate action. In such cases, the auditor may identify

relevant performance measures, whether internal or external, by considering the information that the entity uses to manage its business. If such enquiry indicates an absence of performance measurement or review, there may be an increased risk of misstatements not being detected and corrected.

Considerations specific to public sector entities

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

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

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

- The entity's financial reporting practices in terms of the applicable financial reporting framework, such as:
  - Accounting principles and industry-specific practices, including for industry-specific significant classes of transactions, account balances and related disclosures in the financial report (for example, loans and investments for banks, or research and development for pharmaceuticals).
  - Revenue recognition.
  - Accounting for financial instruments, including related credit losses.
  - Foreign currency assets, liabilities and transactions.
  - Accounting for unusual or complex transactions including those in controversial or emerging areas (for example, accounting for share-based payments).
- An understanding of the entity's selection and application of accounting policies, including any changes thereto as well as the reasons therefore, may encompass such matters as:
  - The methods the entity uses to recognise, measure, present and disclose significant and unusual transactions.
  - The effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.
  - Changes in the environment, such as changes in the applicable financial reporting framework or tax reforms that may necessitate a change in the entity's accounting policies.
  - Financial reporting standards and laws and regulations that are new to the entity and when and how the entity will adopt, or comply with, such requirements.

A80. Obtaining an understanding of the entity and its environment assists the auditor in considering where changes in the entity's financial reporting (e.g., from prior periods) may be expected. For example, if the entity has had a significant business combination during the period, the auditor would likely expect changes in classes of transactions, account balances and disclosures associated with that business combination. Alternatively, if there were no significant changes in the financial reporting framework during the period the auditor's



understanding may help confirm that the understanding obtained in the prior period remains applicable.

- A81. Disclosures in the financial report of smaller and less complex entities may be simpler and less detailed (e.g., some financial reporting frameworks allow smaller entities to provide simpler and less detailed disclosures in the financial report). However, this does not relieve the auditor of the responsibility to obtain an understanding of the entity and its environment, the applicable financial reporting framework as it applies to the entity, and its related system of internal control.

Considerations specific to public sector entities

- A82. The applicable financial reporting framework in a public sector entity is determined by the legislative and regulatory frameworks relevant to each jurisdiction or within each geographical area. Matters that may be considered in the entity's application of the applicable financial reporting requirements, and how it applies in the context of the nature and circumstances of the entity and its environment, include whether the entity applies a full accrual-basis of accounting (such as the International Public Sector Accounting Standards), a cash-basis of accounting, or a hybrid. The financial reporting applied by a public sector entity further impacts the ability to assess the accountability for all assets and liabilities of the entity, as well as the entity's system of internal control.

How Events or Conditions are Subject To, or Affected By, the Inherent Risk Factors

- A83. The auditor is required to consider events or conditions in understanding how the applicable financial reporting framework applies in the context of the nature and circumstances of the entity. In doing so, the auditor identifies how events or conditions are subject to, or affected by, the inherent risk factors, which may assist the auditor in understanding which classes of transactions, account balances and disclosures may be affected. Understanding whether, and the relative degree to which the inherent risk factors affect the events and conditions may assist the auditor in identifying and assessing the risks of material misstatement at the assertion level. Appendix 2 provides examples of events and conditions that may indicate susceptibility to risks of material misstatement, categorised by inherent risk factor.
- A84. The extent to which a class of transactions, account balance or disclosure is subject to, or affected by, complexity or subjectivity, is often closely related to the extent to which it is subject to change or uncertainty. Further, when a class of transactions, account balance or disclosure is subject to, or affected by, complexity, subjectivity, change or uncertainty, these inherent risk factors may create opportunity for management bias, whether unintentional or intentional, and affect susceptibility to misstatement due to management bias or fraud. Accordingly, the auditor's identification of risks of material misstatement, and assessment of inherent risk at the assertion level, are also affected by the interrelationships among the inherent risk factors.
- A85. Events or conditions that may be affected by, or subject to, the susceptibility of misstatement due to management bias or fraud may be indicative of increased risks of material misstatement due to fraud. Accordingly, this may be relevant information for use in accordance with paragraph 24 of ASA 240, which requires the auditor to evaluate whether the information obtained from the other risk assessment procedures and related activities indicates that one or more fraud risk factors are present.
- A86. When complexity is an inherent risk factor, there may be an inherent need for more complex processes in preparing the information, and such processes may be inherently more difficult to apply. As a result, applying them may require specialised skills or knowledge, and may require the use of a management's expert. For example, when there are many potential data sources, with different characteristics, and the processing of that data involves many interrelated steps, the data may be inherently more difficult to identify, capture, access, understand or process.

- A87. When management judgement is more subjective, the susceptibility to misstatement due to management bias, whether unintentional or intentional, may also increase. For example, significant management judgement may be involved in making accounting estimates that have been identified as having high estimation uncertainty, and conclusions regarding methods, models and assumptions may reflect unintentional or intentional management bias.
- A88. Where there are increased opportunities for intentional management bias or fraud (e.g., owner-managed entities where there is an increased opportunity for management override of controls), the auditor may identify an increased susceptibility to misstatement due to management bias or fraud.

**Obtaining an Understanding of the Entity's System of Internal Control** (Ref: Para. 25-26)

- A89. Obtaining an understanding of the components of the entity's system of internal control:
- Assists the auditor in identifying and assessing the risks of material misstatement at the financial statement level and the assertion level; and
  - Provides a basis for the auditor's determination of the extent to which the auditor plans to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures in accordance with ASA 330.
- A90. The auditor is required to perform risk assessment procedures to obtain an understanding of each component of internal control relevant to financial reporting. Paragraphs 27–38 address the matters the auditor is required to understand in relation to the components of the system of internal control. The nature, timing, and extent of risk assessment procedures that the auditor performs to obtain this understanding are matters of the auditor's professional judgement and are based on the auditor's determination as to what will provide sufficient and appropriate audit evidence for the auditor's identification and assessment of risks of material misstatement. Accordingly, the nature, timing and extent of procedures to understand the entity's system of internal control will vary from entity to entity, and may depend on matters such as:
- The size and complexity of the entity, including its IT environment.
  - Previous experience with the entity.
  - The nature of each component<sup>41</sup> of the entity's system of internal control.
  - The nature and form of the entity's documentation, including as it relates to specific controls.
- A91. The entity's use of IT and the nature and extent of changes in the IT environment may also affect the specialised skills that are needed to assist with obtaining the required understanding.
- A92. Appendix 3 further describes the nature of the entity's system of internal control and inherent limitations of internal control, respectively. Appendix 3 also provides further explanation of the components of a system of internal control for the purposes of the Australian Auditing Standards.

*System of Internal Control Relevant to Financial Reporting*

- A93. The entity's system of internal control is designed, implemented and maintained to address identified business risks that threaten the achievement of any of the entity's objectives that concern:

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<sup>41</sup> See paragraph 102.

- The reliability of the entity's financial reporting;
- The effectiveness and efficiency of its operations; and
- Its compliance with applicable laws and regulations.

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

- A94. The entity's system of internal control relevant to financial reporting will include aspects of the system of internal control that relate to the entity's reporting objectives, including its financial reporting objectives, but may also include aspects that relate to its operations or compliance objectives, when such aspects are relevant to financial reporting. For example, controls over compliance with laws and regulations may be relevant to financial reporting when such controls are relevant to the entity's preparation of contingency disclosures in the financial report. In particular, the auditor is required by paragraph 35 to understand how the entity initiates transactions and captures information relevant to financial reporting as part of the auditor's understanding of the information system. Such information may include information from the entity's systems and controls designed to address compliance and operations objectives. Further, some entities may have information systems that are highly integrated such that controls may be designed in a manner to simultaneously achieve financial reporting, compliance and operational objectives, and combinations thereof.
- A95. For the purposes of this ASA, the system of internal control relevant to financial reporting means the system of internal control relevant to the preparation of the financial report in accordance with the requirements of the applicable financial reporting framework.

#### Considerations Specific to Public Sector Entities

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

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

- A97. An entity's system of internal control contains manual elements and automated elements. An entity's mix of manual and automated elements in the entity's system of internal control varies with the nature and complexity of the entity's use of IT. The overall objective and scope of an audit does not differ whether an entity operates in a mainly manual environment, a completely automated environment, or an environment involving some combination of manual and automated elements. An entity's use of IT affects the manner in which the information relevant to financial reporting is processed, stored and communicated, and therefore affects the manner in which the system of internal control relevant to financial reporting is designed and implemented. Each component of the system of internal control may involve some extent of automation. The auditor's understanding of the system of internal control relevant to financial reporting involves understanding the entity's use of IT for each component.
- A98. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement, and further audit procedures based thereon. Automated controls may be more reliable than manual controls because they cannot be as easily bypassed, ignored, or overridden, and they are also less prone to simple errors and mistakes. Automated controls may be more effective than manual controls in the following circumstances:

- High volume of recurring transactions, or in situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated.
- Controls where the specific ways to perform the control can be adequately designed and automated.

*Components of the Entity's System of Internal Control*

- A99. The components of the entity's system of internal control for the purpose of this ASA do not necessarily reflect how an entity designs, implements and maintains its system of internal control, or how it may classify any particular component. Entities may use different terminology or frameworks to describe the various aspects of the system of internal control. For the purpose of an audit, auditors may also use different terminology or frameworks provided all the components described in this ASA are addressed.
- A100. The entity's system of internal control relevant to financial reporting addresses the prevention, detection and correction of misstatements in the entity's financial report; however, the manner in which the individual components operate in this respect differs. The control environment provides the overall foundation for the operation of the other components of the system of internal control. Similarly, the entity's risk assessment process and its process for monitoring the system of internal control are designed to operate in a manner that also supports the entire system of internal control. Therefore these components support the controls within the other components of the entity's system of internal control. Due to the manner in which the controls within these components are designed to operate, they are typically not precise enough to prevent, or detect and correct, misstatements at the assertion level and instead may have an indirect effect on the likelihood that a misstatement will be detected or prevented on a timely basis. These controls may be referred to as "indirect controls."
- A101. In contrast, the information system and communication component, as well as the control activities component, typically include controls that are designed to prevent, or to detect and correct, misstatements at the assertion level for the classes of transactions, account balances and disclosures in the entity's financial report. Such controls may be referred to as "direct controls."
- A102. The nature of each of the components of the entity's system of internal control may also affect the auditor's identification and assessment of the risks of material misstatement as follows:
- The auditor's understanding of the entity's control environment, risk assessment process, and the entity's process to monitor controls are more likely to affect the identification and assessment of risks of material misstatement at the financial statement level.
  - The auditor's understanding of the information system and communication component, and the control activities component, are more likely to affect the identification and assessment of risks of material misstatement at the assertion level.
- A103. Notwithstanding the types of controls that are typically within each component of the entity's system of internal control, direct or indirect controls may exist in any of the components. In particular, the control activities component includes general IT controls, which may include 'indirect controls.' For example, controls that address the continued functioning of automated controls over the processing of transactions, such as controls over the integrity of information in the entity's information system, may also include 'direct controls.'

*Controls Relevant to the Audit (Ref: Para. 26)*

- A104. The auditor identifies controls relevant to the audit in accordance with paragraphs 39 through 41. Controls relevant to the audit are likely to include mainly controls that address potential risks of misstatement at the assertion level (i.e., controls in the control activities component).

However, controls relevant to the audit may also include controls in other components of the system of internal control, i.e., the control environment, the risk assessment process and the process to monitor controls components that address the risks of material misstatement at the assertion level. The auditor evaluates the design of each control relevant to the audit and determines whether it has been implemented in accordance with paragraph 42.

**Understanding the Components of the Entity's System of Internal Control** (Ref: Para. 27-38)

*Control Environment* (Ref: Para. 27)

- A105. The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's system of internal control and its importance in the entity. The control environment sets the tone of an organisation, influencing the control consciousness of its people.
- A106. The control environment relating to smaller and less complex entities is likely to vary from larger or more complex entities. For example, the organisational structure may be simpler and include a small number of employees involved in roles related to financial reporting. Further, those charged with governance in smaller and less complex entities may not include an independent or outside member, and the role of governance may be undertaken directly by the owner-manager where there are no other owners. Accordingly, some considerations about the entity's control environment may be inapplicable or less relevant. For example, if the role of governance is undertaken directly by the owner-manager, the auditor may determine that the independence of those charged with governance is not relevant.
- A107. In addition, audit evidence for elements of the control environment in smaller and less complex entities may not be available in documentary form, in particular where communication between management and other personnel may be informal, but is still effective. For example, such entities may not have a written code of conduct but, instead, develop a culture that emphasises the importance of integrity and ethical behaviour through oral communication and by management example. Consequently, the attitudes, awareness and actions of management or the owner-manager are of particular importance to the auditor's understanding of a smaller and less complex entity's control environment.

**Understanding the Control Environment**

- A108. Audit evidence for the auditor's understanding of the control environment may be obtained through a combination of enquiries and other risk assessment procedures (i.e., corroborating enquiries through observation or inspection of documents). The nature, timing and extent of the auditor's procedures to obtain the understanding of the control environment may vary to the extent necessary, to provide an appropriate basis for the required evaluation in paragraph 28. For example, in considering the extent to which management demonstrates a commitment to integrity and ethical values, the auditor may obtain an understanding through enquiries of management and employees about how management communicates to employees its views on business practices and ethical behaviour and inspecting management's written code of conduct and observing whether management acts in a manner that supports that code.
- A109. The auditor may also consider how management has responded to the findings and recommendations of the internal audit function regarding identified control deficiencies relevant to the audit, including whether and how such responses have been implemented, and whether they have been subsequently evaluated by the internal audit function.
- A110. The auditor's consideration of the entity's use of IT as it relates to the control environment may include such matters as:
- Whether governance over IT is commensurate with the nature and size of the entity and its business operations enabled by IT, including the complexity or maturity of the entity's technology platform or architecture and the extent to which the entity relies on IT applications to support its financial reporting.

- The management organisational structure regarding IT and the resources allocated (for example, whether the entity has invested in an appropriate IT environment and necessary enhancements, or whether a sufficient number of appropriately skilled individuals have been employed including when the entity uses commercial software (with no or limited modifications)).

Evaluating the Control Environment (Ref: Para. 28)

- A111. The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific controls in the control activities component) and thereby, the auditor's identification and assessment of the risks of material misstatement. As further explained in paragraph A218–A219, control deficiencies in the control environment may lead to risks of material misstatement at the financial statement level, which may have implications for the audit, including, as explained in ASA 330, an influence on the nature, timing and extent of the auditor's further procedures.<sup>42</sup>
- A112. Some elements of an entity's control environment have a pervasive effect on assessing the risks of material misstatement. An entity's control consciousness is influenced by those charged with governance, because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment in relation to participation by those charged with governance is therefore influenced by such matters as:
- Their independence from management and their ability to evaluate the actions of management.
  - Whether they understand the entity's business transactions.
  - The extent to which they evaluate whether the financial report is prepared in accordance with the applicable financial reporting framework, including whether the financial report includes adequate disclosures.
- A113. Some entities may be dominated by a single individual who may exercise a great deal of discretion. The actions and attitudes of that individual may have a pervasive effect on the culture of the entity, which in turn may have a pervasive effect on the control environment. Such an effect may be positive or negative. For example, direct involvement by this single individual may be key to enabling the entity to meet its growth and other objectives, and can also contribute significantly to an effective system of internal control. On the other hand, such concentration of knowledge and authority can also lead to an increased susceptibility to misstatement through management override of controls.
- A114. Active involvement by those charged with governance, who are also independent, may influence the philosophy and operating style of senior management. However, other elements may be more limited in their effect. For example, although human resource policies and practices directed toward hiring competent financial, accounting, and IT personnel may reduce the risk of errors in processing financial information, they may not mitigate a strong bias by top management to overstate earnings. Overall, although a control environment that provides an appropriate foundation for the system of internal control may help reduce the risk of fraud, an appropriate control environment is not necessarily an effective deterrent to fraud.

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<sup>42</sup> See ASA 330, paragraphs A2-A3.

*The Entity's Risk Assessment Process* (Ref: Para. 29-31)

- A115. The entity's risk assessment process is an iterative process for identifying and analysing risks to achieving the entity's objectives, and forms the basis for how management or those charged with governance determine the risks to be managed.
- A116. The extent to which an entity's risk assessment process is formalised may vary. Some entities, including smaller and less complex entities, and particularly owner-managed entities, may not have established a structured risk assessment process, or the risk assessment process may not be documented or performed on regular basis. Irrespective whether the risk assessment process is formally established or not, the auditor may still obtain the understanding required by paragraph 29 about how the entity identifies risks relevant to financial reporting and how these risks are addressed through observation and enquiry.

*Understanding the Entity's Risk Assessment Process* (Ref: Para. 29)

- A117. In order to understand how management and those charged with governance have identified business risks relevant to financial reporting objectives, and have decided about actions to address those risks, matters the auditor may consider include how management or, as appropriate, those charged with governance have:
- Specified objectives with sufficient clarity to enable the identification and assessment of the risks relating to the objectives;
  - Identified the risks to achieving the entity's objectives and analysed the risks as a basis for determining how the risks should be managed;
  - Considered the potential for fraud when considering the risks to achieving the entity's objectives; and
  - Identified and evaluated changes that could significantly affect the entity's system of internal control.

As explained in paragraph A59, not all business risks give rise to risks of material misstatement.

- A118. The nature, timing and extent of the auditor's risk assessment procedures to obtain the understanding of the entity's risk assessment process may vary to the extent necessary, to provide an appropriate basis for the required evaluation in paragraph 31.
- A119. Understanding the risks arising from the entity's use of IT identified by the entity, as well as how these risks have been addressed, is an important input to the auditor's identification of risks arising from the use of IT in accordance with paragraph 41. It may also help the auditor understand the nature and extent of automated processes, and the data, used in controls that may be relevant to the audit.

*Evaluating the Appropriateness of the Entity's Risk Assessment Process* (Ref: Para. 31)

- A120. Whether the entity's risk assessment process is appropriate to the circumstances of the entity, including its nature, size, and complexity, is a matter of the auditor's professional judgement. For example, in some smaller and less complex entities, and particularly owner-managed entities, an appropriate risk assessment may be performed through the direct involvement of management or the owner-manager (e.g., the manager or owner-manager may routinely devote time to monitoring the activities of competitors and other developments in the market place to identify emerging risks that may affect how the entity applies the requirements of the applicable financial reporting framework related to the entity's ability to continue as a going concern).

A121. When the auditor determines, in accordance with paragraph 31(b), that a control deficiency exists related to the entity's risk assessment process, the auditor is required to determine, in accordance with paragraph 43, whether any such deficiency constitutes a significant control deficiency. Whether the absence of an appropriate risk assessment process represents a significant control deficiency is a matter of the auditor's professional judgement. Circumstances that may indicate a significant control deficiency exists include matters such as:

- The absence of a risk assessment process when such a process would ordinarily be expected to have been established; or
- Evidence of an ineffective risk assessment process, which may be the case when the process has failed to identify a risk of material misstatement when it would be expected the risk assessment process would have identified the risk.

*The Entity's Process to Monitor the System of Internal Control* (Ref: Para. 32-34)

A122. The entity's process to monitor the system of internal control is a continuous process to evaluate the effectiveness of the system of internal control and to take necessary remedial actions on a timely basis. The entity's process to monitor the system of internal controls may consist of ongoing activities, separate evaluations (conducted periodically), or some combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities. The entity's process will likely vary in scope and frequency depending on the assessment of the risks by the entity.

A123. In smaller and less complex entities, and in particular owner-manager entities, the entity's process to monitor the system of internal control is often accomplished by management's or the owner-manager's direct involvement in operations, and there may not be any other monitoring activities. For example, this is the case when significant variances from expectations and inaccuracies in financial data are identified through the owner-manager's direct involvement. The owner-manager's actions and follow-up may also be how remedial actions are implemented. In such cases, the auditor's understanding of the process to monitor the system of internal control may be accomplished through enquiry of the owner-manager and employees about these activities, and may also involve inspection or observation of related communications or other evidence of remedial actions.

A124. For entities where there is no distinct process for monitoring the system of internal control, it may be difficult to distinguish between controls in the control activities component and activities related to monitoring. For example, a supervisory review may not be considered a monitoring activity by the entity, but the review may have a role in monitoring the effectiveness of underlying controls. For such entities, understanding the process to monitor the system of internal control may include understanding periodic reviews of management accounting information that are designed to contribute to how the entity prevents or detects misstatements.

A125. Controls in the entity's process to monitor the system of internal control are likely to consist of primarily indirect controls. However, monitoring activities, such as management or supervisory reviews, may be precise enough to address risks of material misstatement at the assertion level (i.e., direct controls). Such controls may also include certain activities performed by the internal audit function. The auditor may determine certain direct controls to be controls relevant to the audit in accordance with paragraph 39–41.

*Understanding the Entity's Process to Monitor the System of Internal Control* (Ref: Para. 32)

A126. In order to understand how the entity monitors its system of internal control, matters that may be relevant for the auditor to consider include:



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

A127. The entity's process to monitor the system of internal control includes monitoring underlying controls that involve the use of IT, and may include, for example:

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

A128. Controls within the entity's process to monitor the system of internal control, including those that monitor underlying automated controls, may be automated or manual, or a combination of both. For example, an entity may use automated monitoring controls over access to certain technology with automated reports of unusual activity to management, who manually investigate identified anomalies.

Sources of Information (Ref: Para. 33)

A129. Much of the information used in monitoring may be produced by the entity's information system. If management assumes that information used for monitoring is accurate without having a basis for that assumption, errors that may exist in the information could potentially lead management to incorrect conclusions from its monitoring activities. Accordingly, an understanding of:

- The sources of the information related to the entity's monitoring activities; and
- The basis upon which management considers the information to be sufficiently reliable for the purpose of the monitoring activities

is required to provide a basis for the auditor's understanding of the entity's process to monitor the system of internal control.

A130. Management's monitoring activities may use information in communications from external parties such as customer complaints or regulator comments that may indicate problems or highlight areas in need of improvement.

The Entity's Internal Audit Function (Ref: Para. 34)

A131. If the entity has an internal audit function, the auditor's understanding of the entity's process to monitor the system of internal control involves obtaining an understanding of the role that the internal audit function plays in that process. The auditor's enquiries of appropriate individuals within the internal audit function in accordance with paragraph 18(a) of this ASA

help the auditor obtain an understanding of the nature of the internal audit function's responsibilities. If the auditor determines that the function's responsibilities are related to the entity's financial reporting, the auditor may obtain further understanding of the activities performed, or to be performed, by the internal audit function by reviewing the internal audit function's audit plan for the period, if any, and discussing that plan with the appropriate individuals within the function. This understanding, together with the information obtained from the auditor's enquiries in paragraph 18(a) of this ASA, may also provide information that is directly relevant to the auditor's identification and assessment of the risks of material misstatement.

- A132. If the nature of the internal audit function's responsibilities and assurance activities are related to the entity's financial reporting, the auditor may also be able to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the auditor in obtaining audit evidence. Auditors may be more likely to be able to use the work of an entity's internal audit function when it appears, for example, based on experience in previous audits or the auditor's risk assessment procedures, that the entity has an internal audit function that is adequately and appropriately resourced relative to the size of the entity and the nature of its operations, and has a direct reporting relationship to those charged with governance.
- A133. If, based on the auditor's preliminary understanding of the internal audit function, the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed, ASA 610 applies.
- A134. As is further discussed in ASA 610, the activities of an internal audit function are distinct from other monitoring controls that may be relevant to financial reporting, such as reviews of management accounting information that are designed to contribute to how the entity prevents or detects misstatements.
- A135. Establishing communications with the appropriate individuals within an entity's internal audit function early in the engagement, and maintaining such communications throughout the engagement, can facilitate effective sharing of information. It creates an environment in which the auditor can be informed of significant matters that may come to the attention of the internal audit function when such matters may affect the work of the auditor. ASA 200<sup>43</sup> 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 such information to the auditor's attention. The auditor is then able to take such information into account in the auditor's identification and assessment of risks of material misstatement.

#### *The Information System and Communication*

##### **The Information System Relevant to Financial Reporting (Ref: Para. 35)**

- A136. The information system relevant to financial reporting consists of the policies or procedures, and records, designed and established to:
- Initiate, record, process, and report entity transactions (as well as to capture, process and disclose information about events and conditions other than transactions) and to maintain accountability for the related assets, liabilities, and equity;
  - Resolve incorrect processing of transactions, for example, automated suspense files and procedures followed to clear suspense items out on a timely basis;

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<sup>43</sup> See ASA 200, paragraph 15.

- Process and account for system overrides or bypasses to controls;
- Incorporate information from transaction processing in the general ledger (e.g., transferring of accumulated transactions from a subsidiary ledger);
- Capture and process information relevant to financial reporting for events and conditions other than transactions, such as the depreciation and amortisation of assets and changes in the recoverability of assets; and
- Ensure information required to be disclosed by the applicable financial reporting framework is accumulated, recorded, processed, summarised and appropriately reported in the financial report.

A137. An entity's business processes include the activities designed to:

- Develop, purchase, produce, sell and distribute an entity's products and services;
- Ensure compliance with laws and regulations; and
- Record information, including accounting and financial reporting information.

Business processes result in the transactions that are recorded, processed and reported by the information system. Obtaining an understanding of the entity's business processes, which include how transactions are originated, assists the auditor in obtaining an understanding of the entity's information system relevant to financial reporting in a manner that is appropriate to the entity's circumstances.

A138. The entity's information system relevant to financial reporting may include the use of manual and automated elements, which also affect the manner in which transactions are initiated, recorded, processed, and reported. In particular, procedures to initiate, record, process, and report transactions may be enforced through the IT applications used by the entity, and how the entity has configured those applications. In addition, records in the form of digital information may replace or supplement records in the form of paper documents.

A139. The information system, and related business processes relevant to financial reporting in smaller and less complex entities is likely to be less sophisticated than in larger entities and involve a less complex IT environment, but the role of the information system is just as important. Regardless of the size or nature of the entity, the information system includes relevant aspects of that system relating to information disclosed in the financial report that is obtained from within or outside of the general and subsidiary ledgers. Smaller and less complex entities with direct management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the entity's information system relevant to financial reporting may therefore require less effort in an audit of smaller and less complex entity, and may be more dependent on enquiry than on review of documentation. The need to obtain an understanding, however, remains important to identify risks of material misstatement.

A140. The auditor's understanding of the information system relevant to financial reporting required by paragraph 35 includes understanding the flows of information relating to the entity's significant classes of transactions, account balances, and disclosures in the financial report. The auditor's understanding of the information system relevant to financial reporting is not required to include an understanding of the flows of information related to classes of transactions, account balances or disclosures that are not significant classes of transactions, account balances or disclosures.

A141. Risk identification and assessment is an iterative process. The auditor's expectations formed in paragraph 23 about the classes of transactions, account balances and disclosures may assist the auditor in determining the significant classes of transactions, account balances and disclosures in accordance with paragraph 46, which are those that need to be understood when

obtaining an understanding of the information system in accordance with paragraph 35. For example, the auditor may have an expectation that certain significant classes of transactions related to revenue exist, but in obtaining the understanding about the flows of information in the information system, the auditor may identify additional classes of transactions related to revenue that may be significant.

#### Information Obtained from Outside of the General and Subsidiary Ledgers

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

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

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

#### Understanding the Entity's Use of Information Technology in the Information System (Ref: Para. 35(d))

A144. The auditor is required to understand the IT environment relevant to the entity's information system because the entity's use of IT applications or other aspects in the IT environment may give rise to risks arising from the use of IT. The nature and significance of these risks vary based on whether, and the extent to which, the entity relies on IT, including automated controls, to support the processes in its information system and to maintain the completeness

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<sup>44</sup> See ASA 570 *Going Concern*, paragraphs 19-20.

and accuracy of the underlying data and information. The entity may implement general IT controls in response to these risks. General IT controls may be relevant to the audit and may need to be taken into account in the auditor's assessment of control risk at the assertion level.

A145. Examples of risks arising from the use of IT include:

- Inappropriate reliance on IT applications that are inaccurately processing data, processing inaccurate data, or both.
- Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- Unauthorised changes to data in master files.
- Unauthorised changes to IT applications or other aspects of the IT environment.
- Failure to make necessary changes to IT applications or other aspects of the IT environment.
- Inappropriate manual intervention.
- Potential loss of data or inability to access data as required.

A146. The auditor may take an approach to obtaining the understanding the IT environment that involves identifying the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows through the entity's information system.

A147. In obtaining the understanding of the IT environment, the auditor may also obtain a high-level understanding of the IT processes and the personnel involved in maintaining the IT environment (e.g., the number and skill level of the IT support resources that manage security and changes to the environment), which assists the auditor in understanding the complexity of the IT environment. This understanding may include identifying significant changes in the IT environment, which may be revealed through significant changes in the flows of transactions or information through the entity's information system.

A148. Obtaining the auditor's understanding of the IT environment in accordance with paragraph 35(d), and the auditor's identification of IT applications and other aspects of the IT environment relevant to the audit in accordance with paragraph 40, may involve an iterative process or may be performed concurrently. Matters that may be relevant to the auditor's understanding of the IT environment, or the determination of the aspects that are relevant to the audit, include matters such as:

- The extent of automated procedures for processing, and the complexity of those procedures, including, whether there is highly automated, paperless processing.
- The extent of the entity's reliance on system-generated reports in the processing of information.
- How data is input (i.e., manual input, customer or vendor input, or file load).
- How IT facilitates communication between applications, databases or other aspects of the IT environment, internally and externally, as appropriate, through system interfaces.

- The volume and complexity of data in digital form being processed by the system, including whether accounting records or other information are stored in digital form.
  - Matters related to the individual aspects of the IT environment, for example:
    - The type of application (e.g., a commercial application with little or no customization, or a highly-customised or highly-integrated application that may have been purchased and customised, or developed in-house).
    - The complexity of the nature of the IT applications and the underlying IT infrastructure.
    - The complexity of the security over the IT environment, including vulnerability of the IT applications, databases, and other aspects of the IT environment to cyber security risks, particularly when there are web-based transactions or transactions involving external interfaces.
    - The extent of change within the IT environment (e.g., new aspects of the IT environment or significant changes in the IT applications or the underlying IT infrastructure)
    - Whether there is third-party hosting or outsourcing of IT.
    - Whether the entity is using emerging technologies that affect its financial reporting.
  - Whether there was a major data conversion during the period and, if so, the nature and significance of the changes made, and how the conversion was undertaken.
  - Whether program changes have been made to the manner in which information is processed, and the extent of such changes during the period
- A149. Obtaining an understanding of the entity's IT environment may be more easily accomplished for a smaller and less complex entity that uses commercial software and when the entity does not have access to the source code to make any program changes. Such entities may not have dedicated IT resources but may have a person assigned in an administrator role for the purpose of granting employee access or installing vendor-provided updates to the IT applications. Specific matters that the auditor may consider in understanding the nature of a commercial accounting software package, which may be the single IT application used by a smaller and less complex entity in its information system, may include:
- The extent to which the software is well established and has a reputation for reliability;
  - The extent to which it is possible for the entity to modify the source code of the software; and
  - The nature and extent of modifications that have been made to the software. Many software packages allow for configuration (e.g., setting or amending reporting parameters). These do not usually involve modifications to source code; however, the auditor may consider the extent to which the entity is able to configure the software when considering the completeness and accuracy of information produced by the software that is used as audit evidence.
- A150. Complex IT environments may include highly-customised or highly-integrated IT applications and may therefore require more effort to understand. Financial reporting processes or IT applications may be integrated with other IT applications. Such integration may involve IT applications that are used in the entity's business operations and that provide information to the financial reporting IT applications. In such circumstances, certain IT applications used in

the entity's business operations may be relevant to financial reporting. Complex IT environments also may require dedicated IT departments that have structured IT processes supported by personnel that have software development and IT environment maintenance skills. In other cases, an entity may use third-party service providers to manage certain aspects of, or IT processes within, its IT environment.

**Evaluating the Design of the Information System Controls Relevant to Financial Reporting**  
(Ref: Para. 36)

- A151. The information system relevant to financial reporting comprises the entity's financial reporting processes, and the entity's personnel, IT and other resources, deployed in applying those processes. The objective of those processes is to capture, store and process data from internal and external sources, and to produce the entity's accounting records and the information that the entity needs to include in its financial report. The objective of those processes is also to comply with the requirements and principles in the applicable financial reporting framework, and in other applicable laws or regulations. Paragraphs 10–12 of Appendix 3 sets out further matters for consideration relating to the information system.)
- A152. The design of the information system is established in the policies and procedures that define the nature, timing and extent of the entity's financial reporting processes, and how the entity's personnel, IT and other resources are deployed in applying them. Such controls are referred to in this ASA as information system controls relevant to financial reporting. Such policies and procedures may be formally documented, for example in a financial reporting manual, or may be less formally established through communication by management.
- A153. The auditor's understanding of the information system may be obtained in various ways. The auditor's risk assessment procedures to obtain such understanding may include, for example, a combination of:
- Inspection of policy or process manuals or other documentation of the entity's information system;
  - Enquiries of relevant personnel about the procedures used to initiate, record, process and report transactions or about the entity's financial reporting process; or
  - Observation of the performance of the policies or procedures by entity's personnel.
  - Selecting transactions and tracing them through the applicable process in the information system.
- Enquiry alone, however, is not sufficient for such purposes.
- A154. The audit evidence obtained by these risk assessment procedures is used by the auditor to evaluate the design of the information system controls relevant to the financial reporting and determine whether they have been implemented. In evaluating the design of the entity's information system controls relevant to financial reporting, the auditor considers whether such controls would meet their financial reporting objectives, if implemented as designed and operating effectively.
- A155. The auditor may also use automated techniques by obtaining direct access to, or a digital download from, the databases in the entity's information system that store the accounting records of transactions. By using this information, the auditor may confirm the understanding obtained about how transactions flow through the information system by tracing journal entries, or other digital records related to a particular transaction, or an entire population of transactions, from initiation in the accounting records through to recording in the general ledger. Analysis of complete or large sets of transactions may also result in the identification of variations from the normal, or expected, processing procedures for these transactions, which may result in the identification of additional risks of material misstatement related to non-standard procedures.

- A156. Regardless of the techniques used to evaluate the design of the information system and determine whether it has been implemented, the auditor's understanding of the sources of data, and the IT applications involved in processing that data, may also assist the auditor in understanding the IT environment.
- A157. The entity also establishes controls that are designed to support the operating effectiveness of the controls within the information system. For purposes of the ASAs, controls over the information system are treated as controls in the control activities component and may be identified as controls relevant to the audit. The objectives of such controls may include, for example, maintaining the integrity or security of the data captured, stored or processed, and of the accounting records and information produced by the information system. The auditor is required to evaluate the design of those controls and determine whether they have been implemented, in accordance with paragraph 42. These procedures may be performed together with the procedures performed to evaluate the design of the information system controls relevant to financial reporting. For example, the auditor may perform a walk-through of a transaction to confirm the flow of transactions relevant to the transaction and at the same time, evaluate the design and implementation of controls relevant to the audit that relate to that class of transactions, such as those related to approvals or reconciliations.

*Communication* (Ref: Para. 37)

- A158. Communication by the entity of the financial reporting roles and responsibilities and of significant matters relating to financial reporting involves providing an understanding of individual roles and responsibilities pertaining to the system of internal control relevant to financial reporting. It may include such matters as the extent to which personnel understand how their activities in the information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity. Communication may take such forms as policy manuals and financial reporting manuals, particularly in larger entities.
- A159. Communication may be less structured (e.g., formal manuals may not be used) and easier to achieve in a smaller and less complex entity than in a larger entity due to fewer levels of responsibility and management's greater visibility and availability. Regardless of the size of the entity, open communication channels help ensure that exceptions are reported and acted on.

*Control Activities* (Ref: Para. 38)

- A160. Controls in the control activities component include those controls over the flows of information within the information system relating to significant classes of transactions, account balances and disclosures and the financial reporting process used to prepare the financial report. Such controls consist of application controls and general IT controls, both of which could be manual or automated. Regardless of whether controls are within the IT environment or manual systems, controls may have various objectives and may be applied at various organisational and functional levels. Examples of controls in the control activities component include authorisations and approvals, reconciliations, verifications (such as edit and validation checks or automated calculations), segregation of duties, and physical or logical controls, including those addressing safeguarding of assets.
- A161. Controls in smaller and less complex entities are likely to be similar to those in larger entities, but the formality with which they operate may vary. Further, in smaller and less complex entities, more controls may be directly applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide strong control over important account balances and transactions.
- A162. Some individual controls may consist of both automated and manual aspects, such as controls that may use information produced by IT (e.g., an exception report) that is subject to manual procedures (e.g., review and follow-up). For many entities, most controls may be automated controls or involve a combination of automated and manual aspects because of the extent of



use of IT applications for financial reporting purposes. In some cases, authorisations, approvals and the preparation of reconciliations may involve the use of technology enabled workflow or use of supporting records in digital form.

- A163. The greater the extent of automated controls, or controls involving automated aspects, that management uses and relies on in relation to its financial reporting, the more important it may become for the entity to implement general IT controls that address the continued functioning of the automated aspects of application controls.
- A164. It may be less practicable to establish segregation of duties in smaller and less complex entities that have fewer employees. However, in an owner-managed entity, the owner-manager may be able to exercise more effective oversight through direct involvement than in a larger entity, which may compensate for the generally more limited opportunities for segregation of duties. Although, as also explained in ASA 240, domination of management by a single individual can be a potential control deficiency since there is an opportunity for management override of controls.<sup>45</sup>
- A165. Controls in the control activities component may include controls established by management that address risks of material misstatement related to disclosures not being prepared in accordance with the applicable financial reporting framework. Such controls may relate to information included in the financial report that is obtained from outside of the general and subsidiary ledgers.

Controls Relevant to the Audit (Ref: Para. 39-41)

Determining controls relevant to the audit (Ref: Para. 39)

- A166. Controls relevant to the audit are primarily direct controls and are primarily controls in the control activities component because such controls typically are controls over the entity's information system and address risks of material misstatement at the assertion level. However, there may be direct controls that exist in the control environment, the entity's risk assessment process or the entity's process to monitor the system of internal control components. Controls are required to be relevant to the audit when such controls meet one or more of the criteria included in paragraph 39. However, when multiple controls each achieve the same objective, it is unnecessary to identify each of the control related to such objective.
- A167. Controls relevant to the audit are required to include controls over journal entries because the manner in which an entity incorporates information from transaction processing into the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. The extent to which other controls are relevant to the audit may vary based on the nature of the entity and the auditor's planned approach to further audit procedures. For example, in an audit of a smaller and less complex entity, the entity's information system may not be complex and the auditor may not be required to, or plan to, rely on the operating effectiveness of any controls. Further, the auditor may not have identified any significant risks or any other risks of material misstatement for which it is necessary for the auditor to evaluate the design of controls and determine that they have been implemented. In such an audit, the auditor may determine that there are no controls relevant to the audit other than the entity's controls over journal entries.

Controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence (Ref: Para. 39(a))

- A168. The auditor determines whether there are any risks of material misstatement at the assertion level for which it is not possible or practicable to obtain sufficient appropriate audit evidence through substantive procedures alone as described in paragraph 51. The auditor is required, in

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<sup>45</sup> See ASA 240, paragraph A27.

**Proposed Auditing Standard ASA 315**  
***Identifying and Assessing the Risks of Material Misstatement***

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accordance with ASA 330,<sup>46</sup> to design and perform tests of relevant controls that address such risks of material misstatement when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. As a result, when such controls exist that address these risks, they are relevant to the audit.

Controls that address significant risks (Ref: Para. 39(b))

- A169. The auditor determines whether any assessed risks of material misstatement at the assertion level are significant risks in accordance with paragraph 49. Significant risks are those that exist close to the upper end of the spectrum of inherent risk and therefore are those risks of material misstatement that require the most persuasive audit evidence in accordance with ASA 330.<sup>47</sup> Paragraph 39 requires that the auditor identify controls that address significant risks to be controls relevant to the audit. The risk assessment procedures performed to understand these controls in accordance with paragraph 42 contribute to the audit evidence related to the significant risk.
- A170. Regardless of whether the auditor intends to test the operating effectiveness of controls that address significant risks, the understanding obtained about management's approach to addressing those risks may inform the design and performance of substantive procedures responsive to significant risks as required by ASA 330.<sup>48</sup> Although risks relating to significant non-routine or judgemental matters are often less likely to be subject to routine controls, management may have other responses intended to deal with such risks. Accordingly, the auditor's understanding of whether the entity has designed and implemented controls for significant risks arising from non-routine or judgemental matters includes whether and how management responds to the risks. Such responses might include:
- Controls such as a review of assumptions by senior management or experts.
  - Documented processes for accounting estimations.
  - Approval by those charged with governance.
- A171. For example, where there are one-off events such as the receipt of notice of a significant lawsuit, consideration of the entity's response may include such matters as whether it has been referred to appropriate experts (such as internal or external legal counsel), whether an assessment has been made of the potential effect, and how it is proposed that the circumstances are to be disclosed in the financial report.
- A172. ASA 240<sup>49</sup> requires the auditor to identify the controls that address risks of material misstatement due to fraud as controls relevant to the audit and explains that it is important for the auditor to obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud. In identifying the controls relevant to the audit that address the risks of material misstatement due to fraud, the auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties.
- A173. In some cases, management may not have appropriately responded to significant risks by implementing controls over these significant risks. Failure by management to implement such controls is an indicator of a significant control deficiency.<sup>50</sup>

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<sup>46</sup> See ASA 330, paragraph 8.

<sup>47</sup> See ASA 330, paragraph 7(b).

<sup>48</sup> See ASA 330, paragraph 21.

<sup>49</sup> See ASA 240, paragraphs 27 and A32.

<sup>50</sup> See ASA 265, paragraph A7.

Controls over journal entries (Ref: Para. 39(c))

- A174. An entity's information system typically includes the use of standard journal entries that are required on a recurring basis to record transactions. Examples might be journal entries to record sales, purchases, and cash disbursements in the general or a subsidiary ledger, or to record accounting estimates that are periodically made by management, such as changes in the accounting estimate of uncollectible accounts receivable.
- A175. An entity's financial reporting process also includes the use of non-standard journal entries to record non-recurring, unusual transactions or adjustments. Examples of such entries include consolidation adjustments, entries for a business combination or disposal, or non-recurring estimates such as the impairment of an asset. In manual general ledger systems, non-standard journal entries may be identified through inspection of ledgers, journals, and supporting documentation. When automated procedures are used to maintain the general ledger and prepare financial report, such entries may exist only in electronic form and may therefore be more easily identified through the use of automated techniques. For example, applying automated techniques to analyse an entire population of journal entries within a general ledger may assist in understanding the nature and extent of journal entries made, which account balances are subject to standard or non-standard journal entries, and which entity personnel made or authorised the journal entries. These techniques can be accompanied by enquiries of management or inspection of supporting documentation for journal entries to identify the controls the entity has implemented over journal entries.

Testing of operating effectiveness of controls (Ref: Para. 39(d))

- A176. When the auditor determines that a risk(s) for which substantive procedures alone cannot provide sufficient appropriate audit evidence exists, the auditor is required to, in accordance with ASA 330,<sup>51</sup> design and perform tests of relevant controls. Further, when the auditor voluntarily intends to take into account the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures, such controls are required to be identified as relevant to the audit because ASA 330<sup>52</sup> requires the auditor to design and perform tests of those controls. For example, the auditor may plan to test controls over routine classes of transactions because such testing may be more effective or efficient for large volumes of homogenous transactions.
- A177. The auditor's intentions to test the operating effectiveness of controls may also be influenced by the identified risks of material misstatement at the financial statement level. For example, if deficiencies are identified related to the control environment, this may affect the auditor's overall expectations about the operating effectiveness of direct controls.
- A178. The auditor may plan to test the operating effectiveness of controls over the completeness and accuracy of information produced by the entity when the auditor intends to take into account the operating effectiveness of those controls in designing and performing further audit procedures to determine the reliability of that information for its use as audit evidence. The auditor may also plan to test the operating effectiveness of controls relating to operations and compliance objectives when they relate to data the auditor evaluates or uses in applying audit procedures.

Other controls relevant to the audit (Ref: Para. 39(e))

- A179. The extent to which other controls are identified as relevant to the audit is a matter of the auditor's professional judgement. The auditor's judgement about whether it is appropriate to devote additional attention to evaluating the design of controls and determining whether they

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<sup>51</sup> See ASA 330, paragraph 8.

<sup>52</sup> See ASA 330, paragraph 8(a).

have been implemented in order to provide a basis for the design and performance of further audit procedures is influenced by:

- The auditor's knowledge about the presence or absence of controls obtained from the understanding of the components of the system of internal control. For example, when an engagement is new or the entity has made significant changes to its information system, the auditor may determine that more information about the entity's controls is needed to provide a basis for the design of the auditor's further audit procedures, including to assist the auditor in deciding whether to test the operating effectiveness of such controls; and
- The identification of risks of material misstatement and the related assessments of inherent risk at the assertion level because ASA 330 requires more persuasive audit evidence the higher the auditor's assessment of risk.<sup>53</sup> For risks that are assessed as higher, but are not significant risks, the auditor may identify controls over those risks to be relevant to the audit. Similar to controls over significant risks, the auditor's evaluation of the design of these controls and determination of whether they have been implemented contributes to the audit evidence related to the higher risk. This understanding of controls may also assist the auditor in designing further audit procedures responsive to the risk.

IT Applications and Other Aspects of the IT Environment Relevant to the Audit (Ref: Para 35(d) and 40)

- A180. An entity may be using and relying upon IT to accurately process and maintain the integrity of information in the entity's information system relevant to financial reporting. In obtaining the understanding of the IT environment in accordance with paragraph 35(d), the auditor may have obtained information about the nature and number of the IT applications and the complexity of the IT processes in the entity's IT environment. Obtaining a high-level understanding of the extent to which the entity's IT processes include the implementation of general IT controls may assist the auditor in identifying whether there are IT applications on which management is relying for the purposes of financial reporting and that therefore may be IT applications relevant to the audit. In addition, the auditor is required to take into account the matters included in paragraph 39 because these matters may further assist the auditor in identifying those IT applications for which the entity's general IT controls may be relevant to the audit.
- A181. In smaller and less complex entities that use commercial software and that do not have access to the source code to make any program changes, the entity may not have any IT processes other than, for example, to process updates to the software received from the vendor. Also, in smaller and less complex entities, management may not be relying on the IT applications, and the controls within them, to maintain the integrity of information. For example, management may instead be relying on reconciliations of information about transactions processed by the IT application to hard copy records or external documents (e.g., reconciliation of cash sales to deposits reported on a bank statement). When an entity uses an IT application that is reputable, widely-used and considered reliable, is unable to change its programming, and maintains hard-copy accounting records, the auditor may determine that there are no IT applications relevant to the audit. In such a case, the auditor is also likely to be able to obtain audit evidence about the completeness and accuracy of the information produced by the entity used as audit evidence through substantive testing without the need to test controls over its production.
- A182. In larger entities, the entity may be relying on IT to a greater extent and the IT environment may involve multiple IT applications and the IT processes to manage the IT environment may be complex. When an entity has greater complexity in its IT environment, determining the IT

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<sup>53</sup> See ASA 330, paragraph 7(b).

applications and other aspects of the IT environment that are relevant to the audit is likely to require the involvement of team members with specialised skills in IT.

Matters taken into account in identifying IT applications relevant to the audit

- A183. Automated controls that may be determined to be relevant to the audit in accordance with paragraph 40 may include, for example, automated calculations or input, processing and output controls, such as a three-way match of a purchase order, shipping document, and vendor invoice. System-generated reports that the auditor may intend to use as audit evidence may include, for example, a trade receivable aging report or an inventory valuation report.
- A184. In considering whether the IT applications in which automated controls exist and reports are generated are relevant to the audit, the auditor is likely to consider whether, and the extent to which, the entity may have access to source code that enables management to make program changes to such controls or the IT applications. For system-generated reports to be used as audit evidence, the auditor may obtain audit evidence about the completeness and accuracy of the reports by substantively testing the inputs and outputs of the report. In other cases, the auditor may plan to test the operating effectiveness of the controls over the preparation and maintenance of the report, in which case the IT application from which it is produced is likely to be relevant to the audit.
- A185. Some IT applications may include report-writing functionality within them while some entities may also utilize separate report-writing applications (i.e., report-writers). In such cases, the auditor may need to determine the sources of system-generated reports (i.e., the application that prepares the report and the data sources used by the report) to determine the IT applications relevant to the audit. The data sources used by IT applications may be databases that, for example, can only be accessed through the IT application or by IT personnel with database administration privileges. In other cases, the data source may be a data warehouse that may itself be considered to be an IT application relevant to the audit.
- A186. The entity's ability to maintain the integrity of information stored and processed in the information system may vary based on the complexity and volume of the related transactions and other information. The greater the complexity and volume of data that supports a significant class of transactions, account balance or disclosure, the less likely it may become for the entity to maintain integrity of that information through application controls alone (e.g., input and output controls or review controls). It also becomes less likely that the auditor will be able to obtain audit evidence about the completeness and accuracy of such information through substantive testing alone when such information is used as audit evidence. In some circumstances, when volume and complexity of transactions are lower, management may have an application control that is sufficient to verify the accuracy and completeness of the data (e.g., individual sales orders processed and billed may be reconciled to the hard copy originally entered into the IT application). When the entity relies on general IT controls to maintain the integrity of certain information used by IT applications, the auditor may determine that the IT applications that maintain that information are relevant to the audit.
- A187. The auditor may have identified a risk for which substantive procedures alone are not sufficient because of the entity's use of highly-automated and paperless processing of transactions, which may involve multiple integrated IT applications. In such circumstances, the controls relevant to the audit are likely to include automated controls. Further, the entity may be relying on general IT controls to maintain the integrity of the transactions processed and other information used in processing. In such cases, the IT applications involved in the processing and the storage of the information are likely relevant to the audit.

Identifying other aspects of the IT environment that are relevant to the audit

- A188. The other aspects of the IT environment that may be relevant to the audit include the network, operating system and databases, and in certain circumstances interfaces between IT applications. When there are no IT applications relevant to the audit, other aspects of the IT environment are also not relevant. When there are IT applications relevant to the audit, the

other aspects of the IT environment that are relevant to the audit varies based on the extent to which such aspects support and interact with the IT applications determined to be relevant to the audit. The database(s) that stores the data processed by an IT application relevant to the audit is also relevant to the audit. Similarly, because an IT application's ability to operate is often dependent on the operating system, the operating system is typically relevant to the audit. The network may be relevant to the audit, for example, when an IT application interacts with vendors or external parties through the internet.

**Risks Arising from the Use of IT and General IT Controls Relevant to the Audit (Ref: Para. 41)**

- A189. The extent and nature of the risks arising from the use of IT vary depending on the nature and characteristics of the IT applications and other aspects of the IT environment relevant to the audit. Specific IT risks may result when the entity uses third-party hosting for relevant aspects of its IT environment. It is more likely that there will be more IT risks arising from the use of IT when the volume or complexity of automated application controls is higher and management is placing greater reliance on those controls for effective processing of transactions or the effective maintenance of the integrity of underlying information. Examples of risks arising from the use of IT are included in paragraph A145.
- A190. General IT controls are implemented to address risks arising from the use of IT. Accordingly, the auditor uses the understanding obtained about the IT applications and other aspects of the IT environment that are relevant to the audit and the related risks arising from the use of IT in determining the general IT controls relevant to the audit. In doing so, the auditor may take an approach of understanding the general IT controls that the entity has established over its IT processes for management of access, program change and IT operations for each IT application or other aspect of the IT environment that is relevant to the audit. In some cases, an entity may use common IT processes across its IT environment or across certain IT applications, in which case common risks arising from the use of IT and common general IT controls may be identified.
- A191. In identifying the risks arising from the use of IT, the auditor may also consider the nature of the IT application or other aspect of the IT environment and the reasons for it being determined to be relevant to the audit. For some IT applications or other aspects of the IT environment, the risks identified may relate primarily to unauthorised access or unauthorised program changes. In the case of databases or data warehouses, the auditor may be focused on the risk of inappropriate changes to the data through direct database access and the ability to directly manipulate information.
- A192. In general, a greater number of general IT controls related to IT applications and databases are likely to be relevant to the audit than for other aspects of the IT environment. This is because these aspects are the most closely concerned with the processing and storage of information and most subject to automated controls used in the entity's information system. In identifying general IT controls, the auditor may consider controls over actions of both end users and of the entity's IT personnel or IT service providers.
- A193. Identifying the risks arising from the use of IT and the general IT controls relevant to the audit is likely to require the involvement of team members with specialised skills in IT, other than for the simplest of IT environments. Such involvement is likely to be essential, and may need to be extensive, for complex IT environments. Appendix 4 provides further explanation of the nature of the general IT controls typically implemented for different aspects of the IT environment. In addition, examples of general IT controls for different IT processes are provided.

**Evaluating the Design, and Determining Implementation of, Controls Relevant to the Audit**  
(Ref: Para 42)

- A194. Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements (i.e., the control objective). Implementation of a control

means that the control exists and that the entity is using it. There is little point in assessing the implementation of a control that is not designed effectively, and so the design of a control is considered first. An improperly designed control may represent a significant control deficiency.

- A195. In making risk assessments, the auditor may identify the controls that are likely to prevent, or detect and correct, material misstatement in specific assertions. Generally, it is useful to obtain an understanding of controls and relate them to risks of material misstatement in the context of processes and, when applicable, IT applications in which they exist. The relationship to IT applications assists with relating the general IT controls relevant to the audit to the controls that they support. In many cases, an individual control may not in itself adequately address a risk of material misstatement. Often, only multiple controls, together with other components of the system of internal control, will be sufficient to address a risk of material misstatement.
- A196. Conversely, some controls may have a specific effect on an individual risk of material misstatement at the assertion level embodied in a particular significant class of transactions or account balance. For example, the controls that an entity established to ensure that its personnel are properly counting and recording the annual physical inventory relate directly to the risks of material misstatement relevant to the existence and completeness assertions for the inventory account balance.
- A197. Controls that support other controls are indirect controls. The more indirect the relationship, the less effective that control may be in preventing, or detecting and correcting, misstatements related to the risk of material misstatement. For example, a sales manager's review of a summary of sales activity for specific stores by region ordinarily is only indirectly related to the risks of material misstatement relevant to the completeness assertion for sales revenue. Accordingly, it may be less effective in reducing those risks than controls more directly related thereto, such as matching shipping documents with billing documents. Similarly, a general IT control alone is typically not sufficient to address a risk of material misstatement at the assertion level.
- A198. Risk assessment procedures to obtain audit evidence about the design and implementation of controls relevant to the audit may include:
- Enquiring of entity personnel.
  - Observing the application of specific controls.
  - Inspecting documents and reports.
- Enquiry alone, however, is not sufficient for such purposes.
- A199. Evaluating the design and determining the implementation of controls relevant to the audit is not sufficient to test their operating effectiveness, unless there is some automation that provides for the consistent operation of the controls. For example, obtaining audit evidence about the implementation of a manual control at a point in time does not provide audit evidence about the operating effectiveness of the control at other times during the period under audit. However, the auditor may evaluate the design and determine whether the control has been implemented concurrently with the testing of its operating effectiveness, when, for example, there is some automation that provides for consistent operation of the control and the relevant risks arising from the use of IT have been addressed (e.g., when general IT controls are operating effectively). Tests of the operating effectiveness of controls, including tests of indirect controls, are further described in ASA 330.<sup>54</sup>

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<sup>54</sup> See ASA 330, paragraphs 8-11.

A200. Notwithstanding that the risk assessment procedures to obtain audit evidence about the design and implementation of controls relevant to the audit are not sufficient to test the operating effectiveness of controls (and thus assess control risk below the maximum), these procedures provide information important to the auditor's identification and assessment of the risks of material misstatement, and to the design of further audit procedures. In addition to contributing toward the auditor's understanding of the components of the entity's system of internal control, the results of these risk assessment procedures may:

- Influence the auditor's plans to test the operating effectiveness of the controls. When a control is not designed or implemented effectively, there is no benefit in testing it. Conversely, the auditor may conclude that a control, which is effectively designed and implemented, may be appropriate to test in order to take its operating effectiveness into account in designing substantive procedures. When the auditor plans to test a control, the information obtained about the extent to which the control addresses the risk(s) of material misstatement is an input to the auditor's control risk assessment at the assertion level.
- Provide the auditor with a greater understanding of the risks of material misstatement, including the identification of additional risks of material misstatement. This understanding is used in designing the nature, timing and extent of substantive audit procedures that are responsive to the risks of material misstatement, including when the auditor does not plan to test the operating effectiveness of the controls. For example, the results of these procedures may inform the auditor's consideration of possible deviations in a population when designing audit samples.
- Result in the identification of risks of material misstatement at the financial statement level when the results of the auditor's procedures are inconsistent with expectations about the entity's system of internal control that may have been set based on information obtained during the engagement acceptance or continuance process.

### **Identifying and Assessing the Risks of Material Misstatement**

A201. Information gathered by performing risk assessment procedures, including the audit evidence obtained in evaluating the design of controls relevant to the audit and determining whether they have been implemented, is used as audit evidence to support the risk assessment. The risk assessment determines the nature, timing and extent of further audit procedures to be performed in accordance with ASA 330. In identifying and assessing the risks of material misstatement in the financial report, the auditor exercises professional scepticism in accordance with ASA 200.<sup>55</sup>

A202. The auditor's understanding required by paragraphs 23 to 25, and the identification and assessment of the risks of material misstatement, is an iterative process. For example, the auditor may form initial expectations about the significant classes of transactions, account balances and disclosures based on the understanding of the entity and its environment and the applicable financial reporting framework obtained in accordance with paragraph 23. These expectations may be confirmed or updated as the auditor performs further risk assessment procedures to address the requirements in paragraphs 24 and 25, in particular relating to the auditor's understanding of the entity's information system. Specifically, the auditor may identify additional risks of material misstatement related to the classes of transactions, account balances or disclosures that were expected to be significant, thus confirming their significance. The auditor may also identify risks of material misstatement at the assertion level that are related to classes of transactions, account balances or disclosures not previously considered significant and which may therefore give rise to the identification of additional significant classes of transactions, account balances, or disclosures. (Ref: Para. 45(b) and 46)

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<sup>55</sup> See ASA 200, paragraph 15.



*The Use of Assertions*

- A203. In identifying and assessing the risks of material misstatement, the auditor may use the assertions as described in paragraph A204(a)–(b) below or may express them differently provided all aspects described below have been covered. For example, the auditor may choose to combine the assertions about classes of transactions and events, and related disclosures, with the assertions about account balances, and related disclosures.
- A204. Assertions used by the auditor in considering the different types of potential misstatements that may occur may fall into the following categories:
- (a) Assertions about classes of transactions and events, and related disclosures, for the period under audit:
    - (i) Occurrence—transactions and events that have been recorded or disclosed, have occurred, and such transactions and events pertain to the entity.
    - (ii) Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial report have been included.
    - (iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
    - (iv) Cut-off—transactions and events have been recorded in the correct accounting period.
    - (v) Classification—transactions and events have been recorded in the proper accounts.
    - (vi) Presentation—transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.
  - (b) Assertions about account balances, and related disclosures, at the period end:
    - (i) Existence—assets, liabilities, and equity interests exist.
    - (ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
    - (iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial report have been included.
    - (iv) Accuracy, valuation and allocation—assets, liabilities, and equity interests have been included in the financial report at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.
    - (v) Classification—assets, liabilities and equity interests have been recorded in the proper accounts.
    - (vi) Presentation—assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are

relevant and understandable in the context of the requirements of the applicable financial reporting framework.

- A205. The assertions described in paragraph A204(a)–(b) above, adapted as appropriate, may also be used by the auditor in considering the different types of misstatements that may occur in disclosures not directly related to recorded classes of transactions, events, or account balances. As an example of such a disclosure, the entity may be required to describe its exposure to risks arising from financial instruments, including how the risks arise; the objectives, policies and processes for managing the risks; and the methods used to measure the risks.

**Considerations Specific to Public Sector Entities**

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

***Identifying Risks of Material Misstatement*** (Ref: Para. 45)

- A207. The required understanding of the entity and the environment, the applicable financial reporting framework, and the system of internal control forms the basis for the auditor's identification of risks of material misstatement. Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial report as a whole, and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, they represent circumstances that may pervasively increase the risks of material misstatement at the assertion level.
- A208. Risks of material misstatements that do not relate pervasively to the financial report are risks of material misstatement at the assertion level. The identification of risks of material misstatement at the assertion level is performed before consideration of any controls. The auditor does so based on a preliminary assessment of inherent risk that involves identifying those risks for which there is a reasonable possibility of material misstatement. The assertions to which such risks of material misstatement relate are relevant assertions, and the classes of transactions, account balances and disclosures to which the relevant assertions relate are significant classes of transactions, account balances and disclosures.
- A209. While obtaining the understanding as required by paragraph 23, the auditor takes into account the inherent risk factors. Appendix 2 sets out examples, in the context of the inherent risk factors, of events and conditions that may indicate susceptibility to misstatement that may be material.

**Considerations Specific to Public Sector Entities**

- A210. For public sector entities, the identification of risks at the financial statement level may include consideration of matters related to the political climate, public interest and program sensitivity.

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

- A211. The auditor determines the significant classes of transactions, account balances and disclosures by considering whether there are one or more risks of material misstatement related to the assertions for classes of transactions, account balances and disclosures expected in the financial report (i.e., whether there is a reasonable possibility of being subject to a misstatement that is material, individually or in combination with other misstatements). When there is a remote possibility of a material misstatement with respect to an assertion, there are no identified risks of material misstatement and the assertion is not relevant. In determining the relevant assertions, the auditor considers the information gathered from the auditor's risk

assessment procedures about the identified risks of material misstatement and the assertions that they may affect.

- A212. In determining significant classes of transactions, account balances and disclosures from the identified risks of material misstatement, understanding how the inherent risk factors affect the classes of transactions, account balances and disclosures enables the auditor to consider which related assertions may be subject to risks of material misstatement (see paragraph A83).
- A213. The auditor may also use automated techniques to confirm whether all significant classes of transactions and account balances have been identified by, for example, analysing an entire population of transactions to identify their nature, source, size and volume. By applying automated techniques, the auditor may, for example identify that an account with a zero balance at period end actually was comprised of numerous offsetting transactions and journal entries occurring during the period thus indicating that the account balance or class of transactions may be significant (e.g., a “loan processing suspense” account in a financial institution entity).

#### Identifying Significant Disclosures

- A214. Significant disclosures include both quantitative and qualitative disclosures for which there is one or more relevant assertions. Examples of significant disclosures that have qualitative aspects include disclosures about:
- Liquidity and debt covenants of an entity in financial distress.
  - Events or circumstances that have led to the recognition of an impairment loss.
  - Key sources of estimation uncertainty, including assumptions about the future.
  - The nature of a change in accounting policy, and other relevant disclosures required by the applicable financial reporting framework, where, for example, new financial reporting requirements are expected to have a significant impact on the financial position and financial performance of the entity.
  - Share-based payment arrangements, including information about how any amounts recognised were determined, and other relevant disclosures.
  - Related parties, and related party transactions.
  - Sensitivity analysis, including the effects of changes in assumptions used in the entity’s valuation techniques intended to enable users to understand the underlying measurement uncertainty of a recorded or disclosed amount.

#### *Assessing Risks of Material Misstatement at the Financial Statement Level* (Ref: Para. 47)

- A215. Because risks of material misstatement at the financial statement level have a pervasive effect on the financial report, it may not be possible to identify the specific assertions that are more susceptible to the risk (e.g., risk of management override of controls). In other cases, a number of assertions may be identified as susceptible to the risk, and which may therefore affect the auditor’s risk identification and assessment of risks of material misstatement at the assertion level.
- A216. The evaluation of whether risks identified relate pervasively to the financial report as required by paragraph 45(a) supports the auditor’s ability to perform the assessment of the risks of material misstatement at the financial statement level as required by paragraph 47. The determination of the effect of the risks of material misstatement at the financial statement level on the risks of material misstatement at the assertion level as required by paragraph 47(a) is taken into account in the auditor’s assessment of inherent risk at the assertion level in accordance with paragraph 48(b).

- A217. Risks of material misstatement due to fraud may be particularly relevant to the auditor's consideration of the risks of material misstatement at the financial statement level. For example, the risk of management override of controls may pervasively affect the risks of material misstatement at the assertion level, although the auditor may consider particular assertions to have a greater potential for misstatement based on greater susceptibility to management bias or fraud.
- A218. The auditor's identification and assessment of risks of material misstatement at the financial statement level is influenced by the auditor's understanding of the entity's system of internal control, including the outcome of the evaluations required by paragraphs 28 and 31(b) and any control deficiencies identified in accordance with paragraph 43. In particular, risks at the financial statement level may arise from deficiencies in the control environment or from external events or conditions, such as declining economic conditions.
- A219. The auditor's understanding of the control environment and other components of the system of internal control may raise doubts about the auditability of an entity's financial report, such that it may affect the auditor's opinion or be cause for withdrawal from the engagement. For example:
- Concerns about the integrity of the entity's management may be so serious as to cause the auditor to conclude that the risk of management misrepresentation in the financial report is such that an audit cannot be conducted.
  - Concerns about the condition and reliability of an entity's records may cause the auditor to conclude that it is unlikely that sufficient appropriate audit evidence will be available to support an unmodified opinion on the financial report.
- A220. ASA 705<sup>56</sup> establishes requirements and provides guidance in determining whether there is a need for the auditor to express a qualified opinion or disclaim an opinion or, as may be required in some cases, to withdraw from the engagement where withdrawal is possible under applicable law or regulation.

*Assessing Risks of Material Misstatement at the Assertion Level*

Assessing Inherent Risk (Ref: Para. 48)

Assessing the Likelihood and Magnitude of the Risks of Material Misstatement at the Assertion Level  
(Ref: Para: 48(a))

- A221. The degree to which events or conditions relating to significant classes of transactions, account balances and disclosures are subject to, or affected by, the inherent risk factors affects the degree to which such events and conditions are susceptible to misstatement. The inherent risk factors influence the auditor's assessment of the likelihood and magnitude of misstatement for the identified risks of material misstatement at the assertion level. The greater the degree to which a class of transactions, account balance or disclosures is susceptible to material misstatement, the higher the inherent risk assessment is likely to be.
- A222. The relative degrees of the likelihood and magnitude of a possible misstatement determine where on the spectrum of inherent risk the risk of misstatement is assessed. The higher the combination of likelihood and magnitude, the higher the inherent risk; the lower the combination of likelihood and magnitude, the lower the inherent risk. When considering the potential magnitude of the misstatement, the quantitative and qualitative aspects of the potential misstatement may be relevant. A higher inherent risk assessment may also arise from different combinations of likelihood and magnitude, for example a higher risk assessment could result from a lower likelihood but a very high magnitude. Determining the combination of the likelihood and potential magnitude of a possible misstatement is a matter

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<sup>56</sup> See ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*.

of the auditor's professional judgement. Significant risks, which are identified in accordance with paragraph 49, are those close to the upper end of the spectrum of inherent risk.

- A223. Misstatements in assertions about classes of transactions, account balances or disclosures may be judged to be material due to size, nature or circumstances.
- A224. The assessment of inherent risks for individual risks of material misstatement in relation to audits of smaller and less complex entities may be such that a greater proportion of such risks are assessed close to the lower end of the spectrum of inherent risk.
- A225. In order to develop appropriate strategies for responding to risks of material misstatement, the auditor may designate risks of material misstatement within relative categories along the spectrum of inherent risk, based on their assessment of inherent risk. These relative categories may be described in different ways, for example audit methodologies may use numerical categorisations (e.g., on a scale of one to ten), or the relative placement on the spectrum of inherent risk may be described (e.g., high, medium, low). Regardless of the method of categorisation used, the auditor's assessment of inherent risk is appropriate when the design and implementation of further audit procedures to address the identified risks of material misstatement at the assertion level is responsive to the assessment of inherent risk and the reasons for that assessment.
- A226. In assessing the identified risks of material misstatement at the assertion level, the auditor may conclude that some risks of material misstatement relate more pervasively to the financial report as a whole and potentially affect many assertions, in which case the auditor may update the identification of risks of material misstatement at the financial statement level.
- A227. In circumstances in which risks of material misstatement are identified as financial statement level risks due to their pervasive effect on a number of assertions and that effect is identifiable with specific assertions, the auditor takes into account the evaluation required by paragraph 47(b), including those assertions identified that are affected by those risks when assessing the inherent risk for risks of material misstatement at the assertion level.  
(Ref: Para. 48(b))

**Considerations specific to public sector entities**

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

***Significant Risks*** (Ref: Para. 49)

- A229. In determining significant risks, the auditor may first identify those assessed inherent risks that have been assessed close to the upper end of the spectrum of inherent risk. The determination of which of the assessed inherent risks are close to the upper end of the spectrum of inherent risk, and are therefore significant risks, is a matter of professional judgement, unless the risk is of a type specified to be treated as a significant risk in accordance with the requirements of another ASA (see paragraph A230). Routine, non-complex transactions that are subject to systematic processing are less likely to give rise to significant risks because these are likely to give rise to risks of material misstatement at the assertion level that are assessed as close to the lower end on the spectrum of inherent risk. However, risks of material misstatement that may be assessed as having higher inherent risk and may therefore be assessed as significant risks, may arise from matters such as the following:
- Transactions for which there are multiple acceptable accounting treatments such that subjectivity is involved.
  - Accounting estimates that have high estimation uncertainty or complex models.
  - Complexity in data collection and processing to support account balances.

- Account balances or quantitative disclosures that involve complex calculations
- Accounting principles that may be subject to differing interpretation.
- Changes in the entity's business that involve changes in accounting, for example, mergers and acquisitions.

A230. Significant risks include those risks of material misstatement that are treated as significant in accordance with the requirements of other ASAs. ASA 240 provides further requirements and guidance in relation to the identification and assessment of the risks of material misstatement due to fraud.<sup>57</sup>

#### Implications for the audit

A231. ASA 330 describes the consequences for further audit procedures of identifying a risk as significant. When a risk is assessed as a significant risk, the implications for the audit include the design and implementation of an appropriate response to address the assessed risk, which may include for example the use of more experienced engagement team members, including those with specialised skills, to perform audit procedures or audit work may involve the use of experts. In addition, the ASAs set out required responses, including:

- Controls that address significant risks are required to be identified as relevant to the audit in accordance with paragraph 39.
- ASA 330 requires controls that address significant risks to be tested in the current period (when the auditor intends to rely on the operating effectiveness of such controls) and substantive procedures to be planned and performed that are specifically responsive to the identified significant risk.<sup>58</sup>
- ASA 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of risk.<sup>59</sup>
- ASA 260 requires communicating with those charged with governance about the significant risks identified by the auditor.<sup>60</sup>
- ASA 701 requires the auditor to take into account significant risks when determining those matters that required significant auditor attention, which are matters that may be key audit matters.<sup>61</sup>
- Review of audit documentation by the engagement partner on or before the date of the auditor's report which allows significant matters, including significant risks, to be resolved on a timely basis to the engagement partner's satisfaction.<sup>62</sup>
- ASA 600 requires more involvement by the group engagement partner if the significant risk relates to a component in a group audit and for the group engagement team to direct the work required at the component by the component auditor.<sup>63</sup>

The nature, timing and extent of the involvement of individuals with specialised skills and knowledge may vary throughout the audit.

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<sup>57</sup> See ASA 240, paragraphs 25-27.

<sup>58</sup> See ASA 330, paragraphs 15 and 21.

<sup>59</sup> See ASA 330, paragraph 7(b).

<sup>60</sup> See ASA 260, paragraph 15.

<sup>61</sup> See ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*, paragraph 9.

<sup>62</sup> See ASA 220, paragraphs 17 and A18.

<sup>63</sup> See ASA 600, paragraphs 30 and 31.

**Proposed Auditing Standard ASA 315**  
***Identifying and Assessing the Risks of Material Misstatement***

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*Assessing Control Risk* (Ref: Para. 50)

- A232. The auditor's intention to test the operating effectiveness of controls provides the basis for the auditor's assessment of control risk. In assessing control risk, the auditor takes into account the expectation about the operating effectiveness of the controls (based on the auditor's evaluation of the design effectiveness and implementation of the controls set out in paragraph 42).
- A233. The auditor's assessment of control risk may be done in different ways depending on preferred audit techniques or methodologies. The control risk assessment may be expressed using qualitative categories (for example, control risk assessed as maximum, moderate, minimum) or in terms of the auditor's expectation of how effective the control(s) is in addressing the identified risk. For example, if control risk is assessed as maximum, the auditor contemplates no expectation of the operating effectiveness of controls. If control risk is assessed at less than maximum, the auditor contemplates an expectation of the operating effectiveness of controls.
- A234. If a risk of material misstatement is addressed by one or more controls, the auditor takes into account whether one, or a combination of controls, will address the assessment of inherent risk.
- A235. The assessment of control risk takes into account the expected results from the auditor's planned tests of the operating effectiveness of controls relevant to the audit, including general IT controls. For controls relevant to the audit as determined in accordance with paragraph 39, and for which the auditor intends to test the operating effectiveness, the auditor may identify related general IT controls as relevant to the audit in accordance with paragraph 41. For example, when the auditor plans to test the operating effectiveness of an automated control, the auditor may also plan to test the operating effectiveness of the relevant general IT controls that support the continued functioning of that application control to address the risks arising from the use of IT, and to provide a basis for the auditor's expectation that the application control operated effectively throughout the period. When the auditor expects general IT controls that have been determined to be relevant to the audit to be ineffective, this determination may affect the auditor's assessment of control risk at the assertion level depending on whether the auditor is able to perform other tests to address those risks arising from the use of IT. Further guidance about the procedures that the auditor may perform in these circumstances is provided in ASA 330.<sup>64</sup>

*Risks for Which Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence*  
(Ref: Para. 51)

- A236. Risks of material misstatement may relate directly to the recording of routine classes of transactions or account balances, and the preparation of reliable financial report. Such risks may include risks of inaccurate or incomplete processing for routine and significant classes of transactions such as an entity's revenue, purchases, and cash receipts or cash payments.
- A237. Where such routine business transactions are subject to highly automated processing with little or no manual intervention, it may not be possible to perform only substantive procedures in relation to the risk. For example, the auditor may consider this to be the case in circumstances where a significant amount of an entity's information is initiated, recorded, processed, or reported only in electronic form such as in an information system that involves a high-degree of integration across its IT applications. In such cases:
- Audit evidence may be available only in electronic form, and its sufficiency and appropriateness usually depend on the effectiveness of controls over its accuracy and completeness.

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<sup>64</sup> See ASA 330, paragraphs A29-A31.

**Proposed Auditing Standard ASA 315**  
***Identifying and Assessing the Risks of Material Misstatement***

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- The potential for improper initiation or alteration of information to occur and not be detected may be greater if appropriate controls are not operating effectively.
- A238. ASA 540 provides further guidance related to accounting estimates about risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence.<sup>65</sup>
- A239. Paragraph 39 requires the identification of controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence to be relevant to the audit because the auditor is required, in accordance with ASA 330,<sup>66</sup> to design and perform tests of such controls.

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

- A240. As explained in ASA 320,<sup>67</sup> materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances and disclosures. The auditor's determination of materiality is a matter of professional judgement, and is affected by the auditor's perception of the financial reporting needs of users of the financial report.<sup>68</sup> Classes of transactions, account balances or disclosures are quantitatively or qualitatively material if omitting, misstating or obscuring information about them could reasonably be expected to influence the economic decisions of users taken on the basis of the financial report as a whole.
- A241. There may be classes of transactions, account balances or disclosures that are quantitatively or qualitatively material but have not been determined to be significant classes of transactions, account balances or disclosures (i.e., there are no relevant assertions identified). For example, the entity may have a disclosure about executive compensation for which the auditor has not identified a risk of material misstatement. However, the auditor may determine that this disclosure is material based on the consideration in paragraph A240.
- A242. Audit procedures to address classes of transactions, account balances or disclosures that are quantitatively or qualitatively material but are not determined to be significant are addressed in ASA 330.<sup>69</sup> When a class of transactions, account balance or disclosure is determined to be significant as required by paragraph 46, the class of transactions, account balance or disclosure, is also treated as a material class of transactions, account balance or disclosure for the purposes of paragraph 18 of ASA 330.

*Revision of Risk Assessment* (Ref: Para. 53)

- A243. During the audit, information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example, the risk assessment may be based on an expectation that certain controls are operating effectively. In performing tests of those controls, the auditor may obtain audit evidence that they were not operating effectively at relevant times during the audit. Similarly, in performing substantive procedures the auditor may detect misstatements in amounts or frequency greater than is consistent with the auditor's risk assessments. In such circumstances, the risk assessment may not appropriately reflect the true circumstances of the entity and the further planned audit procedures may not be effective in detecting material misstatements. Paragraphs 16 and 17 of ASA 330 provide further guidance about evaluating the operating effectiveness of controls.

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<sup>65</sup> See ASA 540, paragraphs A87-A89.

<sup>66</sup> See ASA 330, paragraph 8.

<sup>67</sup> See ASA 320, paragraph A1.

<sup>68</sup> See ASA 320, paragraph 4.

<sup>69</sup> See ASA 330, paragraph 18.



**Documentation** (Ref: Para. 54)

- A244. The manner in which the requirements of paragraph 54 are documented is for the auditor to determine using professional judgement. For example, in audits of smaller and less complex entities the documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan.<sup>70</sup> Similarly, for example, the results of the risk assessment may be documented separately, or may be documented as part of the auditor's documentation of further procedures.<sup>71</sup> The form and extent of the auditor's documentation is influenced by the nature, size and complexity of the entity and its system of internal control, availability of information from the entity and the audit methodology and technology used in the course of the audit.
- A245. More detailed documentation may be required where the auditor applies a higher level of professional judgement, for example when exercising professional judgement to support the rationale for difficult judgements made. However, the auditor is not required to document every inherent risk factor that was taken into account in identifying and assessing the risks of material misstatement at the assertion level.
- A246. For the audits of smaller and less complex entities, the form and extent of documentation may be simple in form and relatively brief. It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it. Key elements of understanding documented by the auditor may include those on which the auditor based the assessment of the risks of material misstatement.
- A247. For recurring audits, certain documentation may be carried forward, updated as necessary to reflect changes in the entity's business or processes

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<sup>70</sup> See ASA 300 *Planning an Audit of a Financial Report*, paragraphs 7 and 9.

<sup>71</sup> See ASA 330, paragraph 28.

## **Appendix 1**

(Ref: Para. 23(a)(i), A57)

### **CONSIDERATIONS FOR UNDERSTANDING THE ENTITY AND ITS BUSINESS MODEL**

The appendix provides further matters that the auditor may consider in understanding the entity and its business model.

#### **Activities of the Entity**

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

- Beneficial owners (local, foreign, business reputation and experience) and related parties.
- Use of derivative financial instruments.

**Nature of Special-Purpose Entities**

2. A special-purpose entity (sometimes referred to as a special-purpose vehicle) is an entity that is generally established for a narrow and well-defined purpose, such as to effect a lease or a securitisation of financial assets, or to carry out research and development activities. It may take the form of a corporation, trust, partnership or unincorporated entity. The entity on behalf of which the special-purpose entity has been created may often transfer assets to the latter (for example, as part of a derecognition transaction involving financial assets), obtain the right to use the latter's assets, or perform services for the latter, while other parties may provide the funding to the latter. As ASA 550 indicates, in some circumstances, a special-purpose entity may be a related party of the entity.<sup>72</sup>
3. Financial reporting frameworks often specify detailed conditions that are deemed to amount to control, or circumstances under which the special-purpose entity should be considered for consolidation. The interpretation of the requirements of such frameworks often demands a detailed knowledge of the relevant agreements involving the special-purpose entity.

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<sup>72</sup> See ASA 550, paragraph A7.

## **Appendix 2**

(Ref: Para. A60, A83, A209)

### **EVENTS AND CONDITIONS THAT MAY INDICATE SUSCEPTIBILITY TO RISKS OF MATERIAL MISSTATEMENT**

In obtaining the understanding of the entity and its environment and the applicable financial reporting framework in accordance with paragraph 23, the auditor considers whether and, if so, how events and conditions are subject to by, or affected by, the inherent risk factors.

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

#### **Inherent Risk Factors at the Assertion Level**

##### *Complexity*

###### Regulatory:

- Operations that are subject to a high degree of complex regulation.

###### Business model:

- The existence of complex alliances and joint ventures.

###### Applicable financial reporting framework:

- Accounting measurements that involve complex processes.

###### Transactions:

- Use of off balance sheet finance, special-purpose entities, and other complex financing arrangements.

##### *Subjectivity*

###### Applicable financial reporting framework:

- A wide range of possible measurement criteria of an accounting estimate. For example, management's recognition of depreciation or construction income and expenses.
- Management's selection of a valuation technique or model for a non-current asset, such as investment properties.

##### *Change*

###### Economic conditions:

- Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies.

Markets:

- Operations exposed to volatile markets, for example, futures trading.

Customer loss:

- Going concern and liquidity issues including loss of significant customers.

Industry model:

- Changes in the industry in which the entity operates.

Business model:

- Changes in the supply chain.
- Developing or offering new products or services, or moving into new lines of business.

Geography

- Expanding into new locations.

Entity structure:

- Changes in the entity such as large acquisitions or reorganisations or other unusual events.
- Entities or business segments likely to be sold.

Human resources competence:

- Changes in key personnel including departure of key executives.

IT:

- Changes in the IT environment.
- Installation of significant new IT systems related to financial reporting.

Applicable financial reporting framework:

- Application of new accounting pronouncements.

*Uncertainty*

Reporting:

- Events or transactions that involve significant measurement uncertainty, including accounting estimates, and related disclosures.
- Pending litigation and contingent liabilities, for example, sales warranties, financial guarantees and environmental remediation.

*Susceptibility to misstatement due to management bias or fraud*

Reporting:

- Opportunities for management and employees to engage in fraudulent financial reporting, including omission, or obscuring, of significant information in disclosures.

Transactions:

- Significant transactions with related parties.
- Significant amount of non-routine or non-systematic transactions including intercompany transactions and large revenue transactions at period end.
- Transactions that are recorded based on management's intent, for example, debt refinancing, assets to be sold and classification of marketable securities.

**Other Inherent Risk Factors**

- Constraints on the availability of capital and credit.
- Inconsistencies between the entity's IT strategy and its business strategies.
- Investigations into the entity's operations or financial results by regulatory or government bodies.

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

- Lack of personnel with appropriate accounting and financial reporting skills.
- Control deficiencies, especially those not addressed by management.
- Past misstatements, history of errors or a significant amount of adjustments at period end.

## **Appendix 3**

(Ref: Para. 16(f), 27–38, A51, A92, A105–A165)

### **UNDERSTANDING THE ENTITY’S SYSTEM OF INTERNAL CONTROL**

1. This appendix further explains the components of, as well as the limitations of, the entity’s system of internal control as set out in paragraphs 16(f), 27–38, A51, A92 and A105–A165, as they relate to a financial statement audit.

#### **Components of the System of Internal Control**

##### **Control Environment**

2. The control environment encompasses the following elements:
  - (a) *How the entity demonstrates a commitment to integrity and ethical values.* The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behaviour are the product of the entity’s ethical and behavioural standards or codes of conduct, how they are communicated (e.g., through policy statements), and how they are reinforced in practice (e.g., through management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts). The communication of entity policies on integrity and ethical values may include the communication of behavioural standards to personnel through policy statements and codes of conduct and by example.
  - (b) *How those charged with governance demonstrate independence from management and exercise oversight of the entity’s system of internal control.* An entity’s control consciousness is influenced significantly by those charged with governance. Considerations include whether there are sufficient individuals who are independent from management and objective in their evaluations and decision-making; how those charged with governance identify and accept oversight responsibilities and whether those charged with governance retain oversight responsibility for management’s design, implementation and conduct of the entity’s system of internal control. The importance of the responsibilities of those charged with governance is recognised in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance. Other responsibilities of those charged with governance include oversight of the design and effective operation of whistle blower procedures.
  - (c) How the entity has established, with oversight from those charged with governance, structures, reporting lines, and appropriate authorities and responsibilities in pursuit of its objectives. This includes considerations about:
    - Key areas of authority and responsibility and appropriate lines of reporting;
    - Policies relating to appropriate business practices, knowledge and experience of key personnel, and resource provided for carrying out duties; and
    - Policies and communications directed at ensuring that all personnel understand the entity’s objectives, know how their individual actions interrelate and contribute to those objectives, and recognise how and for what they will be held accountable.

The appropriateness of an entity’s organisation and governance structure depends, in part, on its size and the nature of its activities.

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

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

### **Entity's Risk Assessment Process**

3. For financial reporting purposes, the entity's risk assessment process includes how management identifies business risks relevant to the preparation of financial report in accordance with the entity's applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to respond to and manage them and the results thereof. For example, the entity's risk assessment process may address how the entity considers the possibility of unrecorded transactions or identifies and analyses significant estimates recorded in the financial report.
4. Risks relevant to reliable financial reporting include external and internal events, transactions or circumstances that may occur and adversely affect an entity's ability to initiate, record, process, and report financial information consistent with the assertions of management in the financial report. Management may initiate plans, programs, or actions to address specific risks or it may decide to accept a risk because of cost or other considerations. Risks can arise or change due to circumstances such as the following:
  - *Changes in operating environment.* Changes in the regulatory, economic or operating environment can result in changes in competitive pressures and significantly different risks.
  - *New personnel.* New personnel may have a different focus on or understanding of the system of internal control.



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

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

5. An important management responsibility is to establish and maintain the entity's system of internal control on an ongoing basis. Management's process to monitor the system of internal control includes considering whether controls are operating as intended and that they are modified as appropriate for changes in conditions. The entity's process to monitor the system of internal control may include activities such as management's review of whether bank reconciliations are being prepared on a timely basis, internal auditors' evaluation of sales personnel's compliance with the entity's policies on terms of sales contracts, and a legal department's oversight of compliance with the entity's ethical or business practice policies. Monitoring is done also to ensure that controls continue to operate effectively over time. For example, if the timeliness and accuracy of bank reconciliations are not monitored, personnel are likely to stop preparing them.
6. When distinguishing between a monitoring activity and a control in the control activities component, the underlying details of the activity are considered, especially where the activity involves some level of supervisory review. As also explained in the application material, supervisory reviews are not automatically classified as monitoring activities and it may be a matter of judgement whether a review is classified as a control in the control activities component or a monitoring activity. For example, the intent of a monthly completeness control in the control activities component would be to detect and correct errors, where a

monitoring activity would ask why errors are occurring and assign management the responsibility of fixing the process to prevent future errors. In simple terms, a control in the control activities component responds to a specific risk, whereas a monitoring activity assesses whether controls within each of the five components of the system of internal control are operating as intended.

7. Monitoring activities may include using information from communications from external parties that may indicate problems or highlight areas in need of improvement. Customers implicitly corroborate billing data by paying their invoices or complaining about their charges. In addition, regulators may communicate with the entity concerning matters that affect the functioning of the system of internal control, for example, communications concerning examinations by bank regulatory agencies. Also, management may consider in performing monitoring activities any communications relating to the system of internal control from external auditors.

#### Use of internal audit

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

#### **The Information System and Communication**

10. The information system relevant to financial reporting encompasses policies, procedures and records that:
  - Identify and record all valid transactions.
  - Describe on a timely basis the transactions in sufficient detail to permit proper classification of transactions for financial reporting.
  - Measure the value of transactions in a manner that permits recording their proper monetary value in the financial report.
  - Determine the time period in which transactions occurred to permit recording of transactions in the proper accounting period.
  - Present properly the transactions and related disclosures in the financial report.
  - Capture, process and disclose information about events and conditions other than transactions.
11. The quality of the information affects management's ability to make appropriate decisions in managing and controlling the entity's activities and to prepare reliable financial reports.
12. Communication, which involves providing an understanding of individual roles and responsibilities pertaining to the entity's system of internal control may take such forms as policy manuals, accounting and financial reporting manuals, and memoranda.

Communication also can be made electronically, orally, and through the actions of management.

### **Control Activities**

13. Controls in the control activities component consist of application controls and general IT controls, both of which may be manual or automated in nature, and may pertain to the following:

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

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

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

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

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

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

#### **Benefits of IT**

15. Generally, IT benefits an entity's system of internal control by enabling an entity to:
- Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;
  - Enhance the timeliness, availability, and accuracy of information;
  - Facilitate the additional analysis of information;
  - Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;
  - Reduce the risk that controls will be circumvented; and
  - Enhance the ability to achieve effective segregation of duties by implementing security controls in applications, databases, and operating systems.

#### **Limitations of internal control**

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

## **Appendix 4**

(Ref: Para. A193)

### **CONSIDERATIONS FOR UNDERSTANDING GENERAL IT CONTROLS**

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

1. The nature of the general IT controls (GITCs) typically implemented for each of the aspects of the IT environment
  - (a) Applications

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

General IT controls at the database layer typically address risks arising from the use of IT related to unauthorised updates to financial reporting information in the database through direct database access or execution of a script or program.
  - (c) Operating system

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

General IT controls at the network layer typically address risks arising from the use of IT related to network segmentation, remote access, and authentication. Network controls may be relevant when an entity has web-facing applications used in financial reporting. Network controls are also may be relevant when the entity has significant business partner relationships or third party outsourcing, which may increase data transmissions and the need for remote access.
2. Examples of general IT controls that may be exist by IT process include:
  - (a) Process to manage access:
    - Authentication

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

Controls that allow users to access the information necessary for their job responsibilities and nothing further, which facilitates appropriate segregation of duties.

- Provisioning  
Controls to authorise new users and modifications to existing users' access privileges.
  - Deprovisioning  
Controls to remove user access upon termination or transfer.
  - Privileged access  
Controls over administrative or powerful users' access.
  - User access reviews  
Controls to recertify or evaluate user access for ongoing authorisation over time.
  - Security configuration controls  
Each technology generally has key configuration settings that help restrict access to the environment.
  - Physical access  
Controls over physical access to the data centre and hardware, as such access may be used to override other controls.
- (b) Process to manage program or other changes to the IT environment
- Change management process  
Controls over the process to design, program, test and migrate changes to a production (i.e., end user) environment.
  - Segregation of duties over change migration  
Controls that segregate access to make and migrate changes to a production environment.
  - Systems development or acquisition or implementation  
Controls over initial IT application development or implementation (or in relation to other aspects of the IT environment).
  - Data conversion  
Controls over the conversion of data during development, implementation or upgrades to the IT environment.
- (c) Process to manage IT Operations
- Job scheduling  
Controls over access to schedule and initiate jobs or programs that may affect financial reporting.

- Job monitoring  
Controls to monitor financial reporting jobs or programs for successful execution.
- Backup and recovery  
Controls to ensure backups of financial reporting data occur as planned and that such data is available and able to be accessed for timely recovery in the event of an outage or attack.
- Intrusion detection  
Controls to monitor for vulnerabilities and or intrusions in the IT environment

EXPOSURE DRAFT

**ED 02/18**

(August 2018)

# **Proposed Auditing Standard ASA 2018-1** *Amendments to Australian Auditing Standards*

Issued for Comment by the **Auditing and Assurance Standards Board**



**Australian Government**

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**Auditing and Assurance Standards Board**



## Commenting on this Exposure Draft

Comments on this Exposure Draft should be received by no later than 15 October 2018. Comments should be addressed to:

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Melbourne Victoria 8007 AUSTRALIA

## Formal Submissions

Submissions should be lodged online via the “Work in Progress-Open for Comment” page of the Auditing and Assurance Standards Board (AUASB) website ([www.auasb.gov.au/Work-In-Progress/Open-for-comment.aspx](http://www.auasb.gov.au/Work-In-Progress/Open-for-comment.aspx)) as a PDF document and Word document.

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## CONTENTS

PREFACE

AUTHORITY STATEMENT

CONFORMITY WITH INTERNATIONAL STANDARDS ON AUDITING

	<i>Paragraphs</i>
<b>Application</b> .....	9-10
<b>Operative Date</b> .....	11
<b>Introduction</b>	
Scope of this Auditing Standard .....	12
<b>Objective</b> .....	13
<b>Definition</b> .....	14
<b>Amendments to Auditing Standards</b>	
Amendments to ASA 200 .....	15-24
Amendments to ASA 240 .....	25-46
Amendments to ASA 330 .....	47-83
Amendments to ED 03/18 .....	84-138
Appendix 1: Other Conforming and Consequential Amendments	
Appendix 2: Consequential Amendments to ASA 200 as a Result of Changes Proposed by ED 03/18 <i>Proposed ASA 540</i> and ED 02/18 <i>Proposed ASA 315</i>	

## PREFACE

### Reasons for Issuing ED 02/18

The AUASB issues exposure draft ED 02/18 of proposed Auditing Standard ASA 2018-1 *Amendments to Australian Auditing Standards* pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is a non corporate Commonwealth entity of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act). Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislation Act 2003*.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required, inter alia, to develop auditing standards that have a clear public interest focus and are of the highest quality. Under the Strategic Direction, the AUASB is required to have regard to any programme initiated by the IAASB for the revision and enhancement of the International Standards on Auditing (ISAs) and to make appropriate consequential amendments to the Australian Auditing Standards.

### Main Proposals

This proposed Auditing Standard makes amendments to the requirements and/or application and other explanatory material and/or appendices the of the following Auditing Standards and proposed Auditing Standard:

ASA 200	<i>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards</i> (Issued October 2009 and amended to December 2015)
ASA 240	<i>The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report</i> (Issued October 2009 and amended to May 2017);
ASA 330	<i>The Auditor's Responses to Assessed Risks</i> (Issued October 2009 and amended to December 2015); and
ED 03/18	<i>Proposed Auditing Standard ASA 540 Auditing Accounting Estimates and Related Disclosures</i>

In addition to these, conforming and consequential amendments to other Australian Auditing Standards have been presented in Appendix 1. These changes, in the view of the AUASB, are generally straight forward as they are largely definition changes so have been presented in table format for practicality.

The amendments arise from proposed changes by the International Auditing and Assurance Standards Board (IAASB) in Proposed International Standard on Auditing 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement*.

For background to, and explanation of, the conforming and consequential amendments proposed in ED 02/18, refer to Explanatory Memorandum *Exposure Draft 01/18: Proposed Auditing Standard 315 Identifying and Assessing the Risks of Material Misstatement* and *Exposure Draft 02/18: Proposed Auditing Standard ASA 2018-1 Amendments to Australian Auditing Standards*.

## **Proposed Operative Date**

It is intended that this proposed Auditing Standard will be operative for financial reporting periods commencing on or after 15 December 2020, with early adoption permitted.

## **Request for Comments**

Comments are invited on this Exposure Draft of the proposed issuance of ASA 2018-1 *Amendments to Australian Auditing Standards* by no later than 15 October 2018.

Stakeholders are asked to respond to the AUASB on the following questions in order to inform us when responding to the IAASB on their ED:

1. With respect to the proposed conforming and consequential amendments to:
  - (a) ASA 200 (including Appendix 2), ASA 240 and ED 03/18, are these appropriate to reflect the corresponding changes made in proposed ASA 315?
  - (b) ASA 330, are the changes appropriate in light of the enhancements that have been made in proposed ASA 315, in particular as a consequence of the introduction of the concept of general IT controls relevant to the audit?
  - (c) The other ASAs as presented in Appendix 1, are these appropriate and complete?
2. Do you support the proposed revisions to paragraph 18 of ASA 330 to apply to classes of transactions, account balances or disclosures that are 'quantitatively or qualitatively material' to align with the scope of the proposed stand-back in proposed ASA 315?
3. Effective Date: the IAASB have proposed that the standard will be effective for financial reporting periods commencing on or after 15 December 2020, which is anticipated to be approximately 18 months after approval of the final ISA 315. Do you think this is sufficient period to support effective implementation of the new standard?

### **Australian specific questions**

The AUASB is especially interested in stakeholders views on:

4. Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?
5. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
6. Whether there are any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
7. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the main changes to the requirements of the proposed standard? If significant costs are expected, the AUASB would like to understand:
  - (a) Where those costs are likely to occur;
  - (b) The estimated extent of costs, in percentage terms (relative to audit fee); and
  - (c) Whether expected costs outweigh the benefits to the users of audit services?
8. Are there any other significant public interest matters that stakeholders wish to raise?

**AUTHORITY STATEMENT**

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 2018-1 *Amendments to Australian Auditing Standards* pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

## **Conformity with International Standards on Auditing**

This Auditing Standard has been made for Australian legislative purposes and accordingly there is no equivalent International Standard on Auditing (ISA) issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

# AUDITING STANDARD ASA 2018-1

## *Amendments to Australian Auditing Standards*

### **Application**

9. This Auditing Standard applies to:
- (a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with the *Corporations Act 2001*; and
  - (b) an audit of a financial report, or a complete set of financial statements, for any other purpose.
10. This Auditing Standard also applies, as appropriate, to an audit of other historical financial information.

### **Operative Date**

11. This Auditing Standard is operative for financial reporting periods commencing on or after 15 December 2020.

### **Introduction**

#### **Scope of this Auditing Standard**

12. This Auditing Standard makes amendments to Australian Auditing Standards. The amendments arise from conforming and consequential changes arising from the issuance of ASA 315 *Identifying and Assessing the Risks of Material Misstatement*.

### **Objective**

13. The objective of this Auditing Standard is to make amendments to the following Auditing Standards:
- (a) ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards* (Issued October 2009 and amended to December 2015))
  - (b) ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report* (Issued October 2009 and amended to May 2017); and
  - (c) ASA 330 *The Auditor's Responses to Assessed Risks* (Issued October 2009 and amended to December 2015).); and
  - (d) ED 03/18 *Proposed Auditing Standard ASA 540 Auditing Accounting Estimates and Related Disclosures*

### **Definition**

14. For the purposes of this Auditing Standard, the meanings of terms are set out in each Auditing Standard and in the *AUASB Glossary*.

## **Amendments to Auditing Standards**

### **Amendments to ASA 200**

15. Existing paragraph 7 is amended to read as follows:

The Australian Auditing Standards contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The Australian Auditing Standards 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 report based on conclusions drawn from the audit evidence obtained.

16. Existing paragraph 13 is amended to read as follows:

For the purposes of this Auditing Standard, the following terms have the meanings attributed below:

- (n) Risk of material misstatement means the risk that the financial report is materially misstated prior to audit. This consists of two components, described as follows at the assertion level:
- (i) ...
  - (ii) Control risk means the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's ~~internal~~ controls.

17. Existing footnote 17 to paragraph A30 is amended to read as follows:

See ASA 315 *Identifying and Assessing the Risks of Material Misstatement* ~~through Understanding the Entity and Its Environment~~, paragraph 21 9.

18. Existing paragraph A40 is amended to read as follows:

Inherent risk is influenced by the characteristics of events or conditions that affect the susceptibility to misstatement of an higher for some assertions about a and related classes of transactions, account balances, or and disclosures than for others, before consideration of controls (i.e. inherent risk factors). Depending on the extent to which the assertion is subject to, or affected by, such inherent risk factors, the level of inherent risk varies along 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. 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.

19. Existing paragraph A41 is amended to read as follows:

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 report. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial report, 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 Australian Auditing Standards 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.<sup>18</sup>

20. Existing paragraph A42 is amended (including the insertion of a footnote \*). Details of the proposed changes have been outlined in Appendix 2 of this exposure draft.

21. The following paragraph and footnote(\*) are inserted following existing paragraph A43:

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.\*

\* See ASA 330, paragraph 6

22. Existing footnote 21 to paragraph A52 is amended to read as follows:

See ASA 315, paragraphs ~~517-2240~~.

23. Existing paragraph A66 is amended to read as follows:

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) ...

(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.

24. The following paragraph is inserted following existing paragraph A67:

ASA 315 incorporates considerations specific to audits of smaller entities when such entities are also less complex (i.e. smaller entities for which the majority of the characteristics in paragraph A66(b) apply). Accordingly, in this context, ASA 315 refers to ‘smaller and less complex entities’.

#### **Amendments to ASA 240**

25. Existing paragraph 7 is amended to read as follows:

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.

26. Existing footnote 6 to paragraph 16 is amended to read as follows:

See ASA 315, paragraph ~~22~~40

27. Existing paragraph 17 and footnote 7 are amended to read as follows:

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 ASA 315<sup>7</sup>, the auditor shall perform the procedures in paragraphs ~~24~~18–~~45~~25 to obtain information for use in identifying the risks of material misstatement due to fraud.

28. Existing paragraph 21 is amended to read as follows:

Unless all of those charged with governance are involved in managing the entity,<sup>8</sup> 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)

29. Existing footnote 9 to paragraph 26 is amended as follows:

See ASA 315, paragraphs ~~25~~, ~~47~~(a) and ~~48~~

30. Existing paragraph 28 is amended (including the insertion of a new footnote \*) to read as follows:

The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall ~~obtain an understanding of the entity’s related~~ identify the entity’s controls, including control activities, relevant to that address such risks as controls relevant to the audit, and evaluate their design and determine whether they have been implemented.<sup>\*</sup> (Ref: Para. A32–A33)

\* See ASA 315, paragraphs 39(b) and 42.

31. Existing paragraph 45 is amended to read as follows:

The auditor shall include the following in the audit documentation<sup>12</sup> ~~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 ASA 315.<sup>13</sup>

- (a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial report to material misstatement due to fraud; ~~and~~
- (b) The identified and assessed risks of material misstatement due to fraud at the financial report level and at the assertion level; ~~and~~
- (c) Controls identified to be relevant to the audit because they address assessed risks of material misstatement due to fraud.

32. Existing footnote 13 to paragraph 45 is amended to read as follows:

See ASA 315, paragraph ~~54~~32

33. Existing paragraph A8 is amended to read as follows:

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 controls over its preparation and maintenance ~~where~~ when such controls are identified to be controls relevant to the audit. Due to the characteristics of fraud, the auditor's professional scepticism is particularly important when considering the risks of material misstatement due to fraud.

34. Existing footnote 17 to paragraph A19 is amended to read as follows:

See ASA 315, paragraphs ~~186~~(a) and ~~342~~3, and ASA 610, *Using the Work of Internal Auditors*.

35. Existing paragraph A20 is amended to read as follows:

Those charged with governance of an entity oversee the entity's systems for monitoring risk, financial control and compliance with the law. In many circumstances, 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 the circumstances, 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.<sup>18</sup>

36. Existing paragraph A21 is amended to read as follows:

An understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of ~~internal controls that address over~~ risks of fraud, and the competency and integrity of management. The auditor may obtain this understanding in a number of ways, such as by attending meetings where such discussions take place, reading the minutes from such meetings or making enquiries of those charged with governance.

37. Existing paragraph A23 is amended to read as follows:

In addition to information obtained from applying analytical procedures, other information obtained about the entity and its environment, the applicable financial reporting framework

and the entity's system of internal control may be helpful in identifying the risks of material misstatement due to fraud. The discussion among team members may provide information that is helpful in identifying such risks. In addition, information obtained from the auditor's client acceptance and retention processes, and experience gained on other engagements performed for the entity, for example, engagements to review interim financial information, may be relevant in the identification of the risks of material misstatement due to fraud.

38. Existing paragraph A26 is amended (including the insertion of two footnotes, \* and ^) to read as follows:

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 related to incentives, pressures or opportunities may arise from conditions that create susceptibility to misstatements due to management bias or fraud (which is an inherent risk factor).<sup>\*</sup> Alternatively, fraud risk factors may 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. Risk 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.<sup>^</sup> 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.

\* See ASA 315, paragraph 16(f).

^ See ASA 315, paragraphs 27-28.

39. Existing paragraph A33 is amended to read as follows:

It is therefore important for the auditor to obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud. ~~In doing so, In identifying the controls relevant to the audit that address the risks of material misstatement due to fraud,~~ the auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties. Information from obtaining this understanding identifying these controls, and evaluating their design and determining whether they have been implemented, may also be useful in identifying fraud risks factors that may affect the auditor's assessment of the risks that the financial report may contain material misstatement due to fraud.

40. Existing paragraph A43 is amended (including the insertion of a new footnote \*) to read as follows:

Further, the auditor's consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries<sup>\*</sup> 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.

\* See ASA 315, paragraph 39(c).

41. Existing paragraph A44 is amended to read as follows:

When identifying and selecting journal entries and other adjustments for testing and determining the appropriate method of examining the underlying support for the items selected, the following matters are of relevance:

- *The identification and assessment of the risks of material misstatement due to fraud – the presence of fraud risk factors and other information obtained during the auditor’s identification and assessment of the risks of material misstatement due to fraud may assist the auditor to identify specific classes of journal entries and other adjustments for testing.*
- *Controls that have been implemented over journal entries and other adjustments – effective controls over the preparation and posting of journal entries and other adjustments may reduce the extent of substantive testing necessary, provided that the auditor has tested the operating effectiveness of the controls.*
- *The entity’s financial reporting process and the nature of evidence that can be obtained – for many entities routine processing of transactions involves a combination of manual and automated ~~steps and procedures~~ controls. Similarly, the processing of journal entries and other adjustments may involve both manual and automated ~~procedures and~~ controls. Where information technology is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.*
- *The characteristics of fraudulent journal entries or other adjustments – inappropriate journal entries or other adjustments often have unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual, or seldom-used accounts, (b) made by individuals who typically do not make journal entries, (c) recorded at the end of the period or as post-closing entries that have little or no explanation or description, (d) made either before or during the preparation of the financial report 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 – nonstandard 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.*

*Amendments to ASA 240 Appendix 1*

42. Under the heading *Examples of Fraud Risk Factors*, the following paragraph is inserted following the existing paragraph:

Fraud risk factors related to incentives or pressures typically arise from conditions that create susceptibility to misstatement due to management bias or fraud (which is an inherent risk factor). Fraud risk factors related to opportunities may also arise from other identified inherent risk factors (e.g., 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.

43. Under the heading *Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting* and sub-heading *Opportunities*, the fourth paragraph is amended to read as follows:

~~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.

44. Under the heading *Risk Factors Relating to Misstatements Arising from Misappropriation of Assets* and sub-heading *Opportunities*, the second paragraph is amended to read as follows:

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:

- ...
- ...

45. Under the heading *Risk Factors Relating to Misstatements Arising from Misappropriation of Assets* and sub-heading *Attitudes/Rationalisation*, the second point is amended to read as follows:

- 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.

#### *Amendments to ASA 240 Appendix 2*

46. Under the heading *Consideration at the Assertion Level* the ninth point is amended to read as follows:

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.

#### **Amendments to ASA 330**

47. Existing footnote 1 to paragraph 1 is amended to read as follows:

See ASA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.

48. Existing paragraph 6 is amended to read as follows:

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)

49. Existing paragraph 7 is amended to read as follows:

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 the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and (Ref: Para. A9–A18)
- (b) Obtain more persuasive audit evidence the higher the auditor's assessment of risk. (Ref: Para. A19)

50. Existing paragraph 8 is amended to read as follows:

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) ...
- (b) ...

51. Existing paragraph 10 is amended to read as follows:

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, determine whether the controls to be tested depend upon other controls (indirect controls), and, if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls. (Ref: Para. A30–A31)

52. Existing paragraph 13 is amended to read as follows:

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) ...
53. Existing paragraph 14 is amended to read as follows:
- 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) ...
- (b) ...
54. Existing paragraph 16 is amended to read as follows:
- 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)
55. Existing paragraph 17 is amended to read as follows:
- If deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific enquiries 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.
56. Existing paragraph 18 is amended to read as follows:
- Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each ~~material~~ class of transactions, account balance, and disclosure that is quantitatively or qualitatively material. (Ref: Para. A42–A47)
57. Existing paragraph 27 is amended to read as follows:
- If the auditor has not obtained sufficient appropriate audit evidence as to the risk of material misstatement related to a material financial report 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 report.



58. Existing paragraph A1 is amended to read as follows:

Overall responses to address the assessed risks of material misstatement at the financial report 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 ASA 300, or planned audit procedures, and may include changes to:
  - The auditor's determination of performance materiality in accordance with ASA 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 report 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.~~

59. Existing paragraph A4 is amended to read as follows:

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) ...
- (b) ...
- (c) ...

However, as required by paragraph 18, irrespective of the approach selected, the auditor designs and performs substantive procedures for each ~~material~~ class of transactions, account balance, and disclosure that is quantitatively or qualitatively material.

60. Existing paragraph A9 is amended (including the insertion of a new footnote \*) to read as follows:

ASA 315 requires that the auditor's assessment of the risks of material misstatement at the assertion level is performed by assessing inherent risk and control risk. The auditor assesses inherent risk by assessing the likelihood and magnitude of a material misstatement taking into account how, and the degree to which, identified events or conditions relating to significant classes of transactions, account balances or disclosures are subject to, or affected by, the

inherent risk factors.\* 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.

\* See ASA 315, paragraph 48.

61. Existing paragraph A10 is amended to read as follows:

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 operating effectiveness of controls, and the auditor intends to base the substantive procedures on that low assessment, then the auditor performs tests of those controls, as required by paragraph 8(a). 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.

62. Existing paragraph A18 is amended to read as follows:

In the case of smaller 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.

63. Existing paragraph A20 is amended to read as follows:

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 ~~a~~ relevant assertion, and the auditor intends to rely upon those controls. If substantially different controls were used at different times during the period under audit, each is considered separately.

64. Existing paragraph A24 is amended to read as follows:

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.<sup>3</sup> 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.

65. Existing footnote 3 is amended to read as follows:

See ASA 315, paragraph ~~5130~~.

66. Existing paragraph A27 is amended to read as follows:

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.

67. Existing paragraph A29 is amended to read as follows:

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.~~

68. The following paragraph is inserted following existing paragraph A29:

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 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).

69. The following paragraph (including a footnote \*) is inserted following existing paragraph A29 and the above insertion:

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 ASA 315\* to provide the basis for the design of the auditor's additional procedures to determine whether the underlying controls affected by the deficient general IT control functioned throughout the period. 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 determine such controls to be relevant to the audit (if not already relevant to the audit) and therefore evaluate their design, determine that they have been implemented and perform tests of their operating effectiveness. For example, if a general IT control related to user access is deficient, the entity may have an alternate control whereby IT management reviews end user access reports on a timely basis. Circumstances when an application control may address a risk arising from the use of IT may include when the information that may be affected by the general IT control deficiency can be reconciled to external sources (e.g., a bank statement) or internal sources not affected by the general IT control deficiency (e.g., a separate IT application or data source).

\* See ASA 315, paragraph 41.

70. Existing paragraph A30 is amended to read as follows:

In some circumstances, it may be necessary to obtain audit evidence supporting the effective operation of indirect controls (e.g., general IT controls). As explained in paragraphs A29 to A29b, general IT controls may have been determined to be relevant to the audit in accordance with ASA 315 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.

71. Existing paragraph A31 is deleted.

72. Existing paragraph A32 is amended to read as follows:

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.

73. Existing paragraph A35 is amended to read as follows:

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, enquiries 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.

74. Existing paragraph A36 is amended to read as follows:

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.

75. Existing paragraph A38 is amended to read as follows:

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.

76. Existing paragraph A42 is amended (including the insertion of a new footnote \*) to read as follows:

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, that is quantitatively or qualitatively material.~~ For significant classes of transactions, account balances and disclosures, substantive procedures may have already been performed because paragraph 6 requires the auditor to design and perform further audit procedures that are responsive to the assessed risks of material misstatement at the assertion level. Accordingly, substantive procedures are required to be designed and performed in accordance with paragraph 18:

- When the further audit procedures designed and performed in accordance with paragraph 6 for significant classes of transactions, account balances or disclosures did not include substantive procedures; or
- For each class of transactions, account balance or disclosure that is not a significant class of transactions, account balance or disclosure, but that has been identified as quantitatively or qualitatively material in accordance with ASA 315.\*

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.

\* See ASA 315, paragraph 52.

77. The following paragraph is inserted following existing paragraph A42:

In designing the substantive procedures to be performed, the auditor's consideration of the assertion(s) in which a possible misstatement could occur, and if it were to occur, the effect of that misstatement would be most material, may assist in identifying the appropriate nature, timing and extent of the procedures to be performed.

78. Existing paragraph A45 is amended to read as follows:

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 report 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.

79. Existing paragraph A46 is amended to read as follows:

Because the assessment of the risk of material misstatement takes account of ~~internal~~ controls upon which the auditor intends to rely, 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.

80. Existing paragraph A56 is amended to read as follows:

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.

81. Existing paragraph A60 is amended to read as follows:

An audit of financial report 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 re-evaluate 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. ASA 315 contains further guidance on revising the auditor's risk assessment.<sup>7</sup>

82. Existing footnote 7 to paragraph A60 is amended to read as follows:

See ASA 315, paragraph ~~543~~4.

83. Existing paragraph A62 is amended to read as follows:

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 report.
- 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.

#### **Amendments to ED 03/18**

84. Existing paragraph 4 is amended (including the insertion of a footnote \*) to read as follows:

~~This Auditing Standard ASA 315 requires a separate assessment of inherent risk for identified risks of material misstatement at the assertion level.\* purposes of assessing the risks of material misstatement at the assertion level for accounting estimates. In the context of ASA 540, and d~~ Depending on the nature of a particular accounting estimate, the susceptibility of an assertion to a misstatement that could be material may be subject to or affected by estimation uncertainty, complexity, subjectivity or other inherent risk factors, and the interrelationship among them. As explained in ASA 200,<sup>5</sup> 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 Auditing Standard~~ as the spectrum of inherent risk. (Ref: Para. A8–A9, A65–A66, Appendix 1)

\* See ASA 315, paragraph 48.

85. Existing footnote 5 to paragraph 4 is deleted.

86. Existing paragraph 5 is amended to read as follows:

This Auditing Standard refers to relevant requirements in ASA 315 and ASA 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, 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.

87. Existing paragraph 6 is amended to read as follows:

~~This Auditing Standard ASA 315~~ also requires a separate assessment of control risk when assessing the risks of material misstatement at the assertion level ~~for accounting estimates~~. In assessing control risk, the auditor takes into account whether the auditor's further audit procedures contemplate planned reliance on the operating effectiveness of controls. If the auditor does not ~~perform~~ intend to test 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.<sup>6</sup> (Ref: Para. A10)

88. Existing footnote 6 to paragraph 6 is deleted.

89. Existing paragraph 13 is amended (including sub-headings) to read as follows:

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 ASA 315,<sup>8</sup> the auditor shall obtain an understanding of the following matters related to the entity's accounting estimates. The auditor's procedures to obtain the understanding shall be performed to the extent necessary to obtain sufficient appropriate audit evidence as the ~~provide an appropriate~~ basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. (Ref: Para. A19-A22)

*Obtaining an Understanding of tThe Entity and Its Environment and the Applicable Financial Reporting Framework*

- (a) ...
- (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. (Ref: Para. A24-A25)

(c) ...

(d) ...

*Obtaining an Understanding of tThe Entity's System of Internal Control*

(e) ...

(f) ...

(g) ...

- (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 class of transactions, account balances or disclosures flow through the entity's information system ~~The classes of transactions, events and conditions, that are significant to the financial report and that give rise to the need for, or changes in, accounting estimates and related disclosures;~~ and (Ref: Para. A34-A35)

(ii) ...

- (i) Controls ~~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.
90. Existing footnote 8 to paragraph 13 is amended to read as follows:  
See ASA 315, paragraphs ~~3, 5-6, , 11-12, 15-17 and 20-21~~23-44.
91. Existing paragraph 16 is amended to read as follows:  
In identifying and assessing the risks of material misstatement relating to an accounting estimate and related disclosures at the assertion level, including separately assessing inherent risk and controls risk at the assertion level, as required by ASA 315,<sup>9</sup> 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) ...
- (b) ...
92. Existing footnote 9 to paragraph 16 is amended to read as follows:  
See ASA 315, paragraphs ~~25 and 26~~45-52.
93. Existing paragraph 17 is amended (including the insertion of a footnote \*) to read as follows:  
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.<sup>10</sup> 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,<sup>11</sup> and evaluate whether such controls have been designed effectively, and determine whether they have been implemented.<sup>\*</sup> (Ref: Para. A80)
- \* See ASA 315, paragraph 42.
94. Existing footnote 10 to paragraph 17 is amended to read as follows:  
See ASA 315, paragraph ~~49~~27.
95. Existing footnote 11 to paragraph 17 is amended to read as follows:  
See ASA 315, paragraph ~~39(b)~~29.
96. Existing paragraph 18 is amended to read as follows:  
As required by ASA 330,<sup>12</sup> the auditor's further audit procedures shall be responsive to the assessed risks of material misstatement at the assertion level,<sup>13</sup> considering the reasons for the assessment given to those risks for each significant class of transactions, account balance, or disclosure. The auditor's further audit procedures shall include one or more of the following approaches:
- (a) Obtaining audit evidence from events occurring up to the date of the auditor's report (see paragraph 21);
- (b) Testing how management made the accounting estimate (see paragraphs 22–27); or
- (c) Developing an auditor's point estimate or range (see paragraphs 28–29).
- The auditor's further audit procedures shall take into account that the higher the assessed risk of material misstatement, the more persuasive the audit evidence needs to be.<sup>14</sup> The auditor

shall design and perform further audit procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. (Ref: Para. A81-A84)

97. Existing footnote 12 to paragraph 18 is amended to read as follows:

See ASA 315, paragraphs 6-15 ~~and 18~~.

98. Existing paragraph 19 is amended to read as follows:

As required by ASA 330,<sup>15</sup> 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.<sup>17</sup> (Ref: Para. A85-A89)

99. Existing paragraph 39 is amended to read as follows:

The auditor shall include in the audit documentation:<sup>29</sup> (Ref: Para. A149-A152)

- (a) Key ~~elements~~ aspects of the auditor's understanding of the entity and its environment, the applicable financial reporting framework and including the entity's system of internal control related to the entity's accounting estimates;
- (b) ...
- (c) ...
- (d) ...
- (e) ...

100. Existing paragraph A8 is amended (including the insertion of a footnote \*) to read as follows:

Inherent risk factors are characteristics of ~~conditions and events~~ and conditions that ~~may~~ affect the susceptibility of an assertion to misstatement, before consideration of controls.\*  
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 report.

\* See ASA 315, paragraph 16(f).

101. Existing paragraph A10 is amended to read as follows:

An important consideration for the auditor in assessing control risk at the assertion level is ~~the effectiveness of the design of the controls that whether the auditor intends to rely on operating effectiveness of controls based on the auditor's evaluation of the design effectiveness and the determination that controls have been implemented, and the extent to which the controls address the assessed inherent risks at the assertion level. The auditor's evaluation that controls are effectively designed and have been implemented supports an expectation about the operating effectiveness of the controls in determining whether to test them.~~

102. The sub-heading before existing paragraph A19 is amended to read as follows:

*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)

103. Existing paragraph A19 is amended to read as follows:

Paragraphs ~~2311–4424~~ of ASA 315 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 Auditing Standard relate more specifically to accounting estimates and build on the broader requirements in ASA 315.

104. Existing paragraph A20 is amended to read as follows:

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 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 controls 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 enquiries of management with appropriate responsibilities for the financial report, ~~such as and simple walk-throughs of management's process for making the accounting estimate (including when evaluating whether controls in that process are designed effectively and when determining whether the control has been implemented)~~.

105. Existing paragraph A24 is amended to read as follows:

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 ~~the those~~ 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.<sup>30</sup>

106. The sub-heading before existing paragraph A28 is amended to read as follows:

*The Entity's System of Internal Control* ~~Relevant to the Audit~~

107. Existing paragraph A28 is amended (including the insertion of a footnote \*) to read as follows:

In applying ASA 315,<sup>31</sup> 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 those areas of the control environment ~~elements~~ collectively provide an appropriate foundation for the other components of the system of internal control and whether those other components are undermined by control deficiencies in the control environment.\*

\* See ASA 315, paragraph 38.

108. Existing footnote 31 to paragraph A28 is amended to read as follows:

See ASA 315, paragraph ~~27~~4.

109. Existing paragraph A32 is amended to read as follows:

Understanding how the entity's risk assessment process identifies and addresses risks relating to accounting estimates may assist the auditor in considering changes in:

- ...;
- ...;
- The entity's information systems or IT environment; and
- ...

110. Existing paragraph A34 is amended to read as follows:

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 ~~35~~18(a) and (d) of ASA 315. In obtaining the understanding of the entity's information system as it relates to accounting estimates, the auditor may consider:

- ...
- ...

111. Existing paragraph A35 is amended to read as follows:

During the audit, the auditor may identify classes of transactions, events and conditions that give rise to the need for accounting estimates and related disclosures that management failed to identify. ASA 315 deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including determining whether there ~~is a significant deficiency~~ are one or more control deficiencies in internal control with regard to the entity's risk assessment process.<sup>34</sup>

112. Existing footnote 34 to paragraph A35 is amended to read as follows:

See ASA 315, paragraph ~~43~~7.

113. Existing paragraph A39 is amended to read as follows:

Management may design and implement specific controls around models used for making accounting estimates, whether management's own model or an external model. When the model itself has an increased level of complexity or subjectivity, such as an expected credit loss model or a fair value model using level 3 inputs, controls that address such complexity or subjectivity may be more likely to be identified as relevant to the audit because the assessments of inherent risk may be higher such that the auditor requires more persuasive audit evidence. The auditor's evaluation of the design of such controls and determination of whether such controls have been implemented contributes to the audit evidence related to higher assessed risks. When complexity in relation to models is present, controls over data

integrity are also more likely to be relevant to the audit. Factors that may be appropriate for the auditor to consider in obtaining an understanding of the model and of controls ~~activities~~ relevant to the audit include the following:

- ...
- ...

114. Existing paragraph A44 is amended to read as follows:

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 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.
- ...

115. Existing sub-heading before paragraph A50 is amended to read as follows:

Controls ~~Activities~~ Relevant to the Audit Over Management's Process for Making Accounting Estimates (Ref: Para 13(i))

116. Existing paragraph A50 is amended to read as follows:

The auditor's judgement in identifying controls relevant to the audit, and therefore the need to evaluate the design of those controls and determine whether they have been implemented, relates to management's process described in paragraph 13(h)(ii). The auditor may not identify ~~relevant controls relevant to the audit activities~~ in relation to all ~~the elements aspects~~ of paragraph 13(h)(ii), depending on the degree to which complexity affects ~~associated with~~ the accounting estimate.

117. Existing paragraph A51 is amended to read as follows:

As part of ~~obtaining an understanding of~~ identifying the controls ~~activities~~ relevant to the audit, and evaluating their design and determine whether they have been implemented, the auditor may consider:

- ...
- ...
- ...
- 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.

118. Existing paragraph 52 is amended to read as follows:

When management makes extensive use of information technology in making an accounting estimate, controls relevant to the audit are likely to include general IT controls and application controls. Such controls may address risks related to:

- Whether the IT applications or other aspects of the IT environment ~~information technology system has~~ have the capability and is appropriately configured to process large volumes of data;
- Complex calculations in applying a method. When diverse IT applications systems are required to process complex transactions, regular reconciliations between the IT applications systems are made, in particular when the IT applications systems do not have automated interfaces or may be subject to manual intervention;
- ...
- ...
- ...
- ...
- ...

119. Existing paragraph A53 is amended to read as follows:

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 ASA 315.<sup>36</sup>

120. Existing footnote 36 to paragraph A53 is amended to read as follows:

See ASA 315, paragraph A9977.

121. Existing paragraph A54 is amended to read as follows:

For entities with an internal audit function, its work may be particularly helpful to the auditor in obtaining an understanding of:

- ...
- The design and implementation of controls ~~activities~~ that address the risks related to the data, assumptions and models used to make the accounting estimates;
- ...
- ...

122. Existing paragraph A65 is amended (including the insertion of a footnote \*) to read as follows:

Paragraph A42 of ASA 200 states that the Auditing Standards ~~do not ordinarily refer to inherent risk and control risk separately~~ refer to the "risks of material misstatement" rather than to inherent risk and control risk separately. ~~However, this Auditing Standard ASA 315~~ requires a separate assessment of inherent risk and control risk at the assertion level<sup>\*</sup> to

provide a basis for designing and performing further audit procedures to respond to the risks of material misstatement, including significant risks, ~~at the assertion level for accounting estimates~~ in accordance with ASA 330.<sup>41</sup>

\* See ASA 315, paragraphs 48 and 50.

123. Existing footnote 41 to paragraph A65 is deleted.

124. Existing paragraph A66 is amended to read as follows:

In identifying the risks of material misstatement and in assessing inherent risk in accordance with ASA 315, the auditor is required to take into account the degree to which the accounting estimate is subject to, or affected by, the inherent risk factors described in paragraph 16 of this Auditing Standard ~~estimation uncertainty, complexity, subjectivity, or other inherent risk factors~~. The auditor's consideration of the inherent risk factors may also provide information to be used in ~~determining~~:

- Assessing the likelihood and magnitude of material misstatement (i.e., where inherent risk is assessed on the spectrum of inherent risk); and
- Determining t~~he~~ 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.

125. Existing paragraph A68 is amended to read as follows:

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.

126. Existing paragraph A70 is amended to read as follows:

Events occurring after the date of the financial report 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,<sup>42</sup> regardless of the degree to which the accounting estimate was subject to, or affected by, estimation uncertainty, complexity, subjectivity or other inherent risk factors. Events occurring after the date of the financial report 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.

127. Existing footnote 42 to paragraph A70 is amended to read as follows:

See ASA 315, paragraph 534.

128. Existing paragraph A80 is amended to read as follows:

The auditor's assessment of inherent risk, which takes into account the degree to which an accounting estimate is subject to, or affected by, estimation uncertainty, complexity,

subjectivity or other inherent risk factors, assists the auditor in determining whether any of the risks of material misstatement identified and assessed are a significant risk.

129. The sub-heading before existing paragraph A85 is amended to read as follows:

*When the Auditor Intends to Rely on the Operating Effectiveness of ~~Relevant~~ Controls* (Ref: Para: 19)

130. Existing paragraph A85 is amended (including the insertion of a footnote \*) to read as follows:

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.

\* See ASA 315, paragraph 16(k).

131. Existing paragraph A86 is amended to read as follows:

In determining the nature, timing and extent of testing of the operating effectiveness of controls relating to accounting estimates, the auditor may consider factors such as:

- The nature, frequency and volume of transactions;
- The effectiveness of the design of the controls, including whether controls are appropriately designed to ~~respond to~~ address the assessed inherent related risks of material misstatement, and the strength of the control environment, including governance;
- The importance of particular controls to the overall control objectives and processes in place at the entity, including the sophistication of the information system to support transactions;
- The entity's process to monitoring the system of internal controls and identified deficiencies in the entity's system of internal control;
- The nature of the risks the controls are intended to address, for example, controls related to the exercise of judgement compared with controls over supporting data;
- The competency of those involved in the controls ~~activities~~;
- The frequency of performance of the controls ~~activities~~; and
- The evidence of performance of controls ~~activities~~.

132. Existing paragraph A88 is amended to read as follows:

Circumstances when risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level may exist include:

- ...
- Information supporting one or more relevant assertions is electronically initiated, recorded, processed, or reported. This is likely to be the case when there is a high volume of transactions or data, or a complex model is used, requiring the extensive use of information technology to ensure the accuracy and completeness of the information. A complex expected credit loss provision may be required for a financial



institution or utility entity. For example, in the case of a utility entity, the data used in developing the expected credit loss provision may comprise many small balances resulting from a high volume of transactions. In these circumstances, the auditor may conclude that sufficient appropriate audit evidence cannot be obtained without testing controls around the model used to develop the expected credit loss provision.

In such cases, the sufficiency and appropriateness of the audit evidence may depend on the operating effectiveness of controls over the accuracy and completeness of the information.

133. Existing paragraph A101 is amended to read as follows:

Maintaining the integrity of significant assumptions and the data in applying the method refers to the maintenance of the accuracy and completeness of the data and assumptions through all stages of information processing. A failure to maintain such integrity may result in corruption of the data and assumptions and may give rise to misstatements. In this regard, relevant considerations for the auditor may include whether the data and assumptions are subject to all changes intended by management, and not subject to any unintended changes, during activities such as input, storage, retrieval, transmission or processing. Under these circumstances, the auditor may also determine that the related general IT controls are relevant to the audit.

134. Existing paragraph A104 is amended to read as follows:

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, ASA 315<sup>49</sup> requires the engagement partner to consider whether information obtained from those other engagements is relevant to identifying and assessing 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.

135. Existing footnote 49 to paragraph A104 is amended to read as follows:

See ASA 315, paragraph 208.

136. Existing paragraph A149 is amended to read as follows:

ASA 315<sup>65</sup> and ASA 330<sup>66</sup> 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 ASA 230.<sup>67</sup> In the context of auditing accounting estimates, the auditor is required to prepare audit documentation about key ~~elements~~ aspects of the auditor's understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, 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.

137. Existing footnote 65 to paragraph A149 is amended to read as follows:

See ASA 315, paragraphs ~~5432~~ and ~~A244A152-A247A155~~.

138. The following paragraph is inserted the level above paragraph 1 of Appendix 1:

ASA 315 describes the inherent risk factors and how they are used in identifying and assessing the risks of material misstatement. The following sets out considerations relating to inherent risk factors in the context of accounting estimates.

## Appendix 1

### OTHER CONFORMING AND CONSEQUENTIAL AMENDMENTS

Conforming and consequential amendments to Australian Auditing Standards, other than ASA 200, ASA 240 and ASA 330 have been presented in this Appendix. These changes, in the view of the AUASB, are generally straight forward as they are largely changes to definitions so have been presented in table format for practicality.

Three tables are presented within this appendix. Table 1 shows all other conforming and consequential amendments. Where the other conforming and consequential amendments presented within Table 1 include changes in addition to definition changes, further information is shown within Table 2 or Table 3.

<b>Table 1</b>		
<b>Extant Term in the ASAs</b>	<b>Change Made in Proposed ASA 315</b>	<b>Relevant Paragraph(s) Where Change is Proposed</b>
<b>Changes to Names of Components of the System of Internal Control</b>		
Monitoring of controls (extant ASA 315, para's 22–24)	The entity's process to monitor the system of internal control (ED 01/18, para's 32–34)	ASA 210: <sup>1</sup> Para. A18 (refer to <b>Table 2</b> ) ASA 402: <sup>2</sup> Para. A33 – last bullet Para. A34
The information system, including the related business processes, relevant to financial reporting, and communication (extant ASA 315, para. 18)	The information system, and communication (ED 01/18, para. 35)	ASA 210: Para. A18 (refer to <b>Table 2</b> )
<b>Other Changes</b>		
Monitoring of controls <sup>3</sup> (extant ASA 315, para's 22–24)	Controls within the entity's process to monitor the system of internal control (ED 01/18, para's 32–34)	ASA 402: A39 – first bullet ASA 600: <sup>4</sup> Appendix 2, para. 1, 8th bullet (refer to <b>Table 2</b> )
Control activities (extant ASA 315, para. 20)	Controls (ED 01/18, para. 38)	ASA 250: <sup>5</sup> Para. A23 ASA 265: Para A3 (2nd and 3rd sentences) (refer to <b>Table 2</b> ) ASA 500: Para. A17 ASA 501: <sup>6</sup> Para. A4 ASA 550: <sup>7</sup> Para. A20 ASA 600: Appendix 2, para. 1 (7th bullet)

<sup>1</sup> ASA 210 Agreeing the Terms of Audit Engagements.

<sup>2</sup> ASA 402 Audit Considerations Relating to an Entity Using a Service Organisation.

<sup>3</sup> Where this is used to describe what the entity does, as opposed to the name of the component

<sup>4</sup> ASA 600 Special Considerations – Audits of a Group Financial Report.

<sup>5</sup> ASA 250 Consideration of laws and Regulations in an Audit of a Financial Report

<sup>6</sup> ASA 501 Audit Evidence – Specific Considerations for Inventory and Segment Information

<sup>7</sup> ASA 550 Related Parties

<b>Table 1</b>		
<b>Extant Term in the ASAs</b>	<b>Change Made in Proposed ASA 315</b>	<b>Relevant Paragraph(s) Where Change is Proposed</b>
		Appendix 5, Matters that are relevant to the conduct of the work of the component auditor (1st bullet) <u>ASA 610</u> : <sup>8</sup> Para. A3 Para. A10
Control activities <sup>9</sup> (extant ASA 315, para. 20)	Controls in the control activities component (ED 01/18, para. 38)	<u>ASA 265</u> : Para. A3 (first sentence) (refer to <b>Table 2</b> )
Relevant control activities (extant ASA 315, para. 20)	Controls relevant to the audit (ED 01/18, para. 38)	<u>ASA 300</u> : <sup>10</sup> Para. A21
The auditor shall determine whether changes have occurred since the previous audit that may affect its relevance to the current audit. (extant ASA 315, para. 9)	The auditor shall evaluate whether such information remains relevant and reliable as audit evidence for the current audit. (ED 01/18, para. 21)	<u>ASA 500</u> : Para. A1
Internal control (extant ASA 315, para. 4(c))	The system of internal control (ED 01/18, para. 16(l))	<u>ASA 210</u> : Para. A18 (refer to <b>Table 2</b> ) <u>ASA 265</u> : Para. 1 (second sentence) Para. 2 (first sentence) <u>ASA 620</u> : <sup>11</sup> Para. A4 (first bullet)
Internal control relevant to the audit (extant ASA 315, para. 12)	Controls relevant to the audit (ED 01/18, para. 26)	<u>ASA 402</u> : Para 14(b)
Internal control relevant to the audit. (extant ASA 315, para. 12)	System of internal control relevant to financial reporting (ED 01/18, para. 25)	<u>ASA 260</u> : <sup>12</sup> Para A13, 3rd bullet <u>ASA 265</u> : Para 2 (first sentence) <u>ASA 402</u> : Para. 1 Para. 7(a) Para. 10 (refer to <b>Table 2</b> )
Extant elements of the auditor's understanding of the 'entity and its environment' Extant ASA 315, para. 11 (refer to <b>Table 3</b> )	Revised elements of the auditor's understanding of the 'entity and its environment' (ED 01/18, para. 23 (refer to <b>Table 3</b> ))	All the changes in this section are presented in <b>Table 3</b> <u>ASA 550</u> : Para. A12 <u>ASA 600</u> : Para. A23 <u>ASA 720</u> : <sup>13</sup> Para. A31

<sup>8</sup> ASA 610 Using the Work of Internal Auditors

<sup>9</sup> The proposed change in respect of this reference to 'control activities' is slightly different when compared to the proposed change in the previous row. This is due to the particular construction of the first sentence of ASA 265 paragraph A3; however, the meaning of 'controls' remains the same. Also refer to Table 2.

<sup>10</sup> ASA 300 Planning an Audit of a Financial Report

<sup>11</sup> ASA 620 Using the Work of an Auditor's Expert

<sup>12</sup> ASA 260 Communication with Those Charged with Governance

<sup>13</sup> ASA 720 The Auditor's Responsibilities Relating to Other Information

<b>Table 1</b>		
<b>Extant Term in the ASAs</b>	<b>Change Made in Proposed ASA 315</b>	<b>Relevant Paragraph(s) Where Change is Proposed</b>
Understanding the entity and its environment <sup>14</sup> (extant ASA 315, para. 11)	Understanding the entity and its environment, the applicable financial reporting framework and the system of internal control (ED 01/18, para. 17)	<u>ASA 230:</u> Para. A17 (refer <b>Table 2</b> ) <u>ASA 600:</u> Para. 17 <u>ASA 620:</u> Para. A4 (first bullet) <u>ASA 720 (Revised):</u> Para. A31 (refer <b>Table 3</b> )
Require special audit consideration (in context of significant risks) (extant ASA 315, para. 4(e))	<i>Change as appropriate or delete</i> (ED 01/18, para. 16(k) and A10)	All the changes in this section are presented in <b>Table 2</b> <u>ASA 260:</u> Para. A12 <u>ASA 550:</u> Para. A28 <u>ASA 600:</u> Para. A6 <u>ASA 610:</u> Para. A21 <u>ASA 701:</u> Para. A20
Relevant controls (extant ASA 315, para 13–heading)	Controls relevant to the audit (ED 01/18, para. 26)	<u>ASA 402:</u> Para. 10 (refer <b>Table 2</b> ) Para. 12 (c) and (d) Para. A19 Para. A22 (hanging paragraph) Para. A29 Para. A30 (1st and 2nd sentences) Para. A33
Relevant controls (extant ASA 315, para 13–heading)	<i>Change as appropriate</i>	<u>ASA 530:</u> <sup>15</sup> Appendix 2, factor 1 (refer <b>Table 2</b> ) <u>ASA 550:</u> Para. A34 – last sentence (refer <b>Table 2</b> )
Identifying and assessing the risks of material misstatement through understanding the entity and its environment (name of standard)	Identifying and assessing the risks of material misstatement	<u>ASA 210:</u> Footnote 14 <u>ASA 220:</u> <sup>16</sup> Footnote 13 <u>ASA 230:</u> Footnote 5 Appendix <u>ASA 250:</u> <sup>17</sup> Footnote 4 <u>ASA 260 (Revised):</u> Footnote 4 <u>ASA 265:</u> Footnote 1

<sup>14</sup> When reference is made to the auditor's understanding of the entity and its environment, and in the specific context used, are intended to be inclusive of the auditor's understanding of internal control

<sup>15</sup> ASA 530 Audit Sampling

<sup>16</sup> ASA 220 Quality Control for an Audit of a Financial Report and Other Historical Financial Information

<sup>17</sup> ASA 250 Consideration of Laws and Regulations in an Audit of Financial Statements

<b>Table 1</b>		
<b>Extant Term in the ASAs</b>	<b>Change Made in Proposed ASA 315</b>	<b>Relevant Paragraph(s) Where Change is Proposed</b>
		<u>ASA 300:</u> Footnote 4 <u>ASA 320:</u> <sup>18</sup> Footnote 3 <u>ASA 402:</u> Footnote 1 <u>ASA 500:</u> Footnote 1
Identifying and assessing the risks of material misstatement through understanding the entity and its environment (name of standard)	Identifying and assessing the risks of material misstatement	<u>ASA 505:</u> <sup>19</sup> Footnote 14 <u>ASA 510:</u> <sup>20</sup> Footnote 4 <u>ASA 520:</u> <sup>21</sup> Footnote 1 <u>ASA 550:</u> Footnote 1 <u>ASA 570:</u> <sup>22</sup> Footnote 3 <u>ASA 600:</u> Footnote 7 <u>ASA 610:</u> Footnote 1 <u>ASA 700:</u> Footnote 35 <u>ASA 701:</u> Footnote 5 <u>ASA 720:</u> Footnote 11 <u>ASA 800:</u> Footnote 5
Relevant assertion (this is now a defined term)	<i>As appropriate</i>	Refer to <b>Table 2:</b> ASA 265 para. A8
<i>Aspects of the entity's</i> information system (ASA 315, para. 18)	Alignment to the requirements to understanding the information system. (ED 01/18, para. 35)	<u>ASA 402:</u> Para. 3 (refer to <b>Table 2</b> )

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<sup>18</sup> ASA 320 Materiality in Planning and Performing an Audit

<sup>19</sup> ASA 505 External Confirmations

<sup>20</sup> ASA 510 Initial Audit Engagements—Opening Balances

<sup>21</sup> ASA 520 Analytical Procedures

<sup>22</sup> ASA 570 *Going Concern*

**Table 2**

**Description of components of the system of internal control**

**1. ASA 210, para. A18**

It is for management to determine what internal control is necessary to enable the preparation of the financial report. 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.<sup>15</sup> 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.

**ASA 210, footnote 15**

See ASA 315, paragraph A9959 and Appendix 34

**Controls within the entity’s process to monitor the system of internal control**

**2. ASA 600, Appendix 2, paragraph 1 (8th bullet)**

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

**Control activities**

**3. ASA 265, para. 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~~.

**Table 2**

**‘Controls relevant to the audit’, and the ‘system of internal control’**

**4. ASA 402, para. 10**

When obtaining an understanding of the system of internal control relevant to ~~the audit~~ financial reporting in accordance with ASA 315,<sup>4</sup> the user auditor shall evaluate the design and implementation of ~~relevant~~ controls relevant to the audit at the user entity that relate to the services provided by the service organisation, including those that are applied to the transactions processed by the service organisation. (Ref: Para. A12–A14)

**ASA 402, footnote 4**

See ASA 315, paragraph ~~25~~<sup>42</sup>.

**Describing aspects of the entity and its environment in extant ASA 315:**

**5. ASA 230, para. 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 ASA 320,<sup>9</sup> assessed risks, significant matters noted during the audit, and conclusions reached.

**References to risks that ‘require special audit consideration’**

**6. ASA 260, para. 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.

**7. ASA 550, para. A28**

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

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.

**Table 2**

**8. ASA 600, para. A6**

The group engagement team may also identify a component as likely to include significant risks of material misstatement of the group financial report due to its specific nature or circumstances. ~~(that is, risks that require special audit consideration<sup>14</sup>)~~. 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.

**ASA 600, footnote 14**

~~See ASA 315, paragraphs 27–29.~~

**9. ASA 610, para. A21**

As explained in ASA 315,<sup>22</sup> ~~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.

**ASA 610, footnote 22**

See ASA 315 ~~(as amended)~~, paragraph 4(k)(e).

**10. ASA 701, para. A20**

ASA 315 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 one or a combination of the inherent risk factors affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should that misstatement occur; or
- That is to be treated as a significant risk in accordance with the requirement of other ASAs,<sup>23</sup> that, in the auditor's judgement, requires special audit consideration. 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.

**ASA 701 footnote \***

See ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*, paragraph 27 and ISA 550 *Related Parties*, paragraph 18.

**Extant references to relevant controls**

**11. ASA 530**

**Appendix 2, factor 1**

An increase in the extent to which the auditor's risk assessment takes into account ~~relevant~~ controls that address the risk of material misstatement.



**Table 2**

**12. ASA 550, para. 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 ASA 330 requirement to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls,<sup>26</sup> 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.

**Extant references to 'relevant assertion'**

**13. ASA 265, para. A8**

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 internal control may increase the risks of misstatement to such an extent as to give rise to a significant deficiency.

**Alignment to the requirements to understanding the information system**

**14. ASA 402, para. 3**

Services provided by a service organisation are relevant to the audit of a user entity's financial report 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. Although most controls at the service organisation are likely to relate to financial reporting, there may be other 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 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 report; 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 report; 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 report; and~~
  - (ii) Information about events and conditions, other than transactions, is captured, processed and disclosed by the user entity in the financial report.

**Table 2**

- |     |  |
|-----|--|
| (b) | <del>(e) The related accounting records, either in electronic or manual form, supporting information and specific accounts in the user entity's financial report 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;</del> |
| (d) | <del>How the user entity's information system captures events and conditions, other than transactions, that are significant to the financial report;</del>   |
| (c) | <del>(e) The financial reporting process used to prepare the user entity's financial report 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</del>   |
| (d) | <u>The entity's IT environment relevant to (a) to (c) above.</u>   |
| (f) | <del>Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.</del>   |

**Table 3**

**Describing aspects of the entity and its environment in extant ASA 315** (*changes to the description of the entity and its environment are described below*):

**1. ASA 550, para. 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 enquiries specified by paragraph 13 still applies because management may be aware of parties that meet the related party definition set out in this ASA. In such a case, however, the auditor's enquiries 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 ASA 315 to obtain information regarding the entity's organisational structure, ownership, governance and business model.:

- 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 enquiries 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.

**2. ASA 600, para. A23**

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

ASA 315 contains guidance on matters the auditor may consider when obtaining an understanding of the entity and its environment, including:

- 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;
- Relevant industry, regulatory, and other external factors that affect the entity;;
- The relevant measurement used, internally and externally, to assess and review of the entity's financial performance; and
- The including the applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and.<sup>17</sup>

Appendix 2 of this ASA contains guidance on matters specific to a group including the consolidation process.

**ASA 600, footnote 17**

See ASA 315, paragraphs ~~A17-A41~~ A49-A88.

**Table 3**

**3. ASA 720, para. 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 ASA 315.<sup>11</sup> ASA 315 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~~ Relevant industry, regulatory, and other external factors;  
The nature of the entity;  
The entity's selection and application of accounting policies;  
The entity's objectives and strategies;
- (c) The relevant measures used, internally and externally, to assess measurement and review of the entity's financial performance; and
- (d) The applicable financial reporting framework; and
- (e) The entity's system of internal control.

**ASA 720, footnote 11**

See ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*, paragraphs ~~2341~~ 2512.

**Proposed amendments to the auditor's required understanding of 'the entity and its environment'**

The following describes extant elements of the auditor's understanding of the 'entity and its environment' – ASA 315 paragraph 11:

*The Entity and Its Environment*

The auditor shall obtain an understanding of the following:

- (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework. (Ref: Para. A25–A30)
- (b) The nature of the entity, including:
  - (i) its operations;
  - (ii) its ownership and governance structures;
  - (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
  - (iv) the way that the entity is structured and how it is financed, to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial report. (Ref: Para. A31–A35)

**Table 3**

- (c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry. (Ref: Para. A36)
- (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. (Ref: Para. A37-A43)
- (e) The measurement and review of the entity's financial performance. (Ref: Para. A44-A49)

The following describes the revised elements of the auditor's understanding of the 'entity and environment' – ED 01/18 paragraph 23:

The auditor shall perform risk assessment procedures to obtain an understanding of the entity and its environment and the applicable financial reporting framework. In doing so, the auditor shall obtain an understanding of the following matters to provide an appropriate basis for understanding the classes of transactions, account balances and disclosures to be expected in the entity's financial report:

- (a) The entity and its environment, including:
  - (i) 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; (Ref: Para A49-A63)
  - (ii) Relevant industry, regulatory and other external factors; and (Ref: Para. A64-A69)
  - (iii) The relevant measures used, internally and externally, to assess the entity's financial performance. (Ref: Para. A70-A78)
- (b) The applicable financial reporting framework, including: (Ref: Para.A79-A82)
  - (i) How it applies in the context of the nature and circumstances of the entity and its environment, including how events or conditions are subject to, or affected by, the inherent risk factors; and (Ref: Para.A83-A88)
  - (ii) The entity's accounting policies and any changes thereto, including the reasons for any changes to the entity's accounting policies.

**Changes will also be made to the AUASB Glossary as needed.**

## Appendix 2

(Ref: Para. 20)

### CONSEQUENTIAL AMENDMENTS TO ASA 200 AS A RESULT OF CHANGES PROPOSED BY ED 03/18 PROPOSED ASA 540 AND ED 02/18 PROPOSED ASA 315

Consequential amendments have been proposed to paragraph A42 of ASA 200<sup>23</sup> in ED 04/18<sup>24</sup> as well as through this Exposure Draft (ED 02/18). To assist stakeholders with understanding the effect of the changes of both ED 04/18 and ED 02/18, the amendments have been stepped out below from the extant ASA 200.

1. Existing paragraph A42 of ASA 200 is amended by ED 04/18 (including the insertion of new footnotes, \* and ^) to read as follows:

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 Australian Auditing Standards do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risks of material misstatement.” However, ASA 540\* 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 assessed risks of material misstatement, including significant risks, for accounting estimates at the assertion level in accordance with ASA 330.^ 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. 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.

\* See ASA 540 Auditing Accounting Estimates and Disclosures, paragraph 15.

^ See ASA 330, paragraph 7(b).

**The proposed effective date of the amendments in ED 04/18 is 15 December 2019.**

2. The above amended paragraph and footnotes are further amended by changes to paragraph A42 of ASA 200 in ED 02/18, proposed ASA 315, to read as follows:

The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made. In most cases, the Australian Auditing Standards 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, ASA 540315\* requires a separate assessment of inherent risk and control risk at the assertion level to provide a basis for designing and performing further audit procedures to respond to the assessed risks of material misstatement, including significant risks, for accounting estimates at the assertion level in accordance with ASA 330.^ 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

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<sup>23</sup> ASA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards

<sup>24</sup> ED 04/18 Proposed Auditing Standard ASA 2018-2 Amendments to Australian Auditing Standards

assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations.

\* See ASA 540~~315~~ *Auditing Accounting Estimates and Disclosures* Identifying and Assessing the Risks of Material Misstatement, paragraph 15.

<sup>△</sup> See ASA 300, paragraph 7(b).

**The proposed effective date of the amendments in ED 02/18 is 15 December 2020.**



# AUASB Board Meeting Summary Paper

## AGENDA ITEM NO. 5.1.1

**Meeting Date:** 12 September 2018  
**Subject:** Agreed Upon Procedures (ISRS 4400)  
**Prepared by:** Rene Herman  
**Date Prepared:** 3 September 2018

☒ **Action Required**

☐ **For Information Purposes Only**

IAASB Project Objective	AUASB SMEs
<p>(i) Redraft the standard using the clarity drafting conventions so that this standard is consistent with other IAASB International Standards.</p> <p>(ii) Revise the standard to better reflect practice in Agreed-Upon Procedures (AUP) engagements being undertaken.</p>	Robin / Rene
AUASB Key Points	
<u>Background, overall comments and what is required from the AUASB</u>	
<ul style="list-style-type: none"><li>At the March 2018 AUASB meeting, the Audit Technical Group (ATG) provided the AUASB with a project status update in relation to the revised international project on Agreed Upon Procedures. At that meeting, the ATG noted that the IAASB standard was progressing in the direction expected by the AUASB and consistent with the Australian standard with the exception of the exercise of professional judgement; and independence.</li><li>The IAASB has accelerated their timetable with respect to AUP's, and at the IAASB September 2018 meeting is seeking approval to issue the Exposure Draft of proposed ISRS 4400 for public consultation. To facilitate an accelerated timeframe, the IAASB held a teleconference in August 2018 to discuss the matters of professional judgement and ethics.<ul style="list-style-type: none"><li>The ATG provided feedback on the August 2018 IAASB meeting papers directly to the 2 Australasian IAASB members. The ATG had concerns in the area of the exercise of professional judgement, where it was appearing as though the IAASB may be going down a different path to the Australian ASRS 4400.</li><li>The ATG were observers on this teleconference and noted that the comments provided to the Australasian members were raised on the teleconference.</li></ul></li><li>The ATG noted that there were varying views expressed by IAASB members on the role of professional judgement in an AUP engagement and by the end of the call, it was noted that this area was contentious with no current consensus one way or another.</li><li>The ATG has provided below a summary of key matters arising from the review of the September 2018 AUP meeting papers. The most significant matters relate to:</li></ul>	

*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*



- exercise of professional judgement that is still not aligned to the current Australian position (refer key point 1 below for analysis); and
- use versus distribution of an AUP report (refer key point 3 below for analysis).

*What the ATG is seeking from the AUSAB at this September meeting:*

- The ATG expect that the IAASB will vote to issue this draft standard as an exposure draft at its September 2018 meeting. Accordingly, now is a key time for the AUASB to provide comments into the IAASB.
- The ATG is seeking comments / input from the AUASB on the matters described below as well as feedback on the proposed timetable / timeline

### **Key Points arising from review of IAASB September 2018 papers**

#### **1. Professional Judgement:**

*The basis for concern*

One of the differentiating factors between an agreed-upon procedures engagement and an assurance engagement is the extent to which the assurance practitioner's professional judgement is exercised in selecting procedures. The major distinguishing feature between assurance engagements and AUPs, widely agreed, is that:

- in an agreed-upon procedures engagement, professional judgement may be exercised in assisting the engaging party to identify procedures when agreeing the terms of the engagement, but only professional competence and skill is exercised in conducting the procedures and in this way adds value to the engagement; while
- in an assurance engagement, professional judgement is exercised in both selecting and conducting procedures.

Therefore, one of the most significant attributes of an agreed-upon procedures engagement is the lack of subjectivity in both the procedures and the resultant factual findings. Applying judgement requires a level of subjectivity, so the AUASB considers that it is not be appropriate for the practitioner to exercise professional judgement when conducting agreed-upon procedures.

*AUASB technical group comment on draft ISRS 4400:*

On a close reading of the draft standard, the AUASB technical group can see a logical build to the draft ISRS 4400 in relation to the exercise of professional judgement. To build up to what ASRS 4400 currently has in its paragraph 25 (see below) will require a complete read of paragraphs 14(b), 19, 21(b), 22(h), 26, A15-A17 of draft ISRS 4400. In contrast, while the Australian ASRS 4400 requirement comes out with a clear statement in paragraph 25 that the assurance practitioner will not be required, during the course of the engagement, to exercise professional judgement in determining or modifying the procedures to be performed, the ISRS 4400 draft is more subtle in this respect.

Paragraph 25 of ASRS 4400:

*The nature, timing and extent of procedures shall be specified in the terms of the engagement in sufficient detail such that the assurance practitioner will not be required, during the course of the engagement, to exercise professional judgement in determining or modifying the procedures to be performed.*

*Recommendations by the ATG:*

- The ATGs primary recommendation is the adoption of the wording from paragraph 25 of ASRS 4400.
- Recognising that this is unlikely to be achieved, the ATGs second option is to tighten up and consolidate the content of paragraphs 19, 21(b), 22(h) and A15-A17 so as to come up with a simplified single paragraph that explains how professional judgement is exercised in AUP engagements. This would require a rewrite of these paragraphs.
- The third and least preferred option that the ATG suggests is:
  - the wording of paragraph 19 could be tightened to read: *The practitioner shall apply professional judgement taking into consideration the nature of the procedures agreed to be performed in the terms characteristics of an agreed-upon procedures engagement.*
  - Additionally, the words currently used in paragraph 21(b) could be moved and included within paragraph 22(h), so that paragraph 22(h) reads: *Nature, timing and extent of the procedures to be performed, need to be described objectively, in terms that are clear, not misleading and not subject to varying interpretations.*

- d. The AUASB Chair will share recommendations a)-c) above with the IAASB Australasian members and other IAASB members recognising that a) above is the most preferable but that c) may be the most pragmatic approach given that this exposure draft is expected to be approved at the September IAASB meeting. The AUASB submission to the IAASB exposure draft can then push for recommendation a).

**Question for AUASB:** Does the AUASB agree with the recommendation outlined in d) above? Any other views in relation to the exercise of professional judgement?

**2. Parties involves in AUP engagement / Engagement acceptance:**

- a. intended users – definition Agenda Item 5A Para 9(d) inconsistent with ASRS 4400. IAASB definition – “*will use report*” verses AUASB definition “*for whom report is prepared*”. IAASB definition – wider capture.

*Technical Group Comment:*

The only time the use of the term intended users arises in the requirements of ISRS 4400 is in relation to the definition of an agreed upon procedures engagement (refer below). :

*An engagement in which a practitioner is engaged to carry out those procedures to which the practitioner and the engaging party have agreed and to report the procedures performed and the related findings. The engaging party and intended users assess for themselves the procedures and findings reported by the practitioner and draw their own conclusions from them.*

ASRS 4400 has a requirement that puts the onus on the practitioner to obtain an understanding of the needs and objectives of the intended user.

Proposed ISRS 4400 takes the view that it is the engaging parties and not the practitioners’ responsibility to determine that the intended users understand the procedures and that the procedures are appropriate for their purpose. To this end paragraph A23 explains that agreeing the procedures to be performed with the engaging party helps to provide the engaging party with a basis to acknowledge that the procedures to be performed are appropriate for the purpose of the engagement; and paragraph A28 focuses on actions that the engaging party may take (for example, discussing proposed procedures with intended users) so that the engaging party is able to acknowledge the appropriateness of the procedures to be performed.

**Technical Group Comment:** The ATG does not foresee any issues with this change of direction and considers this to be practical.

**Question for AUASB:** Does the AUASB agree with the ATG comment above?

**3. Restriction on use/distribution of reports**

- a. Paragraph A28 – demonstrates how the intended user may be informed of the AUP procedures where they may not be a party to the engagement letter.
- b. Paragraph 29(1) – purpose of report and may not be suitable for other purpose.
- c. Paragraph A42 – may include restriction on use or distribution.

**Technical Group Comment:**

*Australian ASRS 4400:*

The AUASB made a distinction between *use* of an AUP report and *distribution* of such a report, this distinction was deliberately included in the requirements of ASRS 4400. The purpose of the distinction is not to prevent distribution of a report per se, but to deter use of that report by those other than the intended users which are identified in the terms of engagement.

Paragraph 42/ASRS 4400 specifically restricts the **use of** the report to ‘*those parties that have either agreed to the procedures to be performed or have been specifically included as intended users in the engagement letter....*’. Reliance on that report is effectively restricted to the intended users identified, even if the report is distributed to other parties. A restriction **on use** paragraph is required to include in an AUP report.

<p><i>Proposed ISRS 4400:</i></p> <p>A restriction on use is not clear from the draft ISRS 4400.</p> <ul style="list-style-type: none"> <li>• There is no requirement within the proposed standard to restrict use.</li> <li>• Paragraph A42 provides application material on purpose, restriction on use or distribution. The restriction wording used in the example AUP report within the draft ISRS 4400 is '<i>solely for the purpose of assisting.....and may not be suitable for another purpose. The report is intended solely for the [engaging party] and [intended users], and should not be distributed to any other party</i>'</li> </ul> <p><i>ATG proposals:</i></p> <ul style="list-style-type: none"> <li>• A restriction on use requirement should be included within paragraph 29</li> <li>• Paragraph A42 and the example report should remove reference to restriction on distribution as practically this is not possible.</li> </ul> <p><b>Question for AUASB:</b> Does the AUASB agree with the ATG proposals above?</p> <p><b><u>Other matters arising from review of IAASB September 2018 papers</u></b></p> <p><b>1. Independence:</b></p> <p>a. ASRS 4400 requires the assurance practitioner to maintain independence equivalent to the independence requirements applicable to Other Assurance Engagements and to disclose in their report if modified independence requirements are agreed.</p> <p>b. Proposed ISRS 4400 requires the practitioner to comply with relevant ethical requirements. The application material, paragraphs A11-A12, supporting this requirement is unclear. The ATG is seeking further clarity on these paragraphs to understand the implications.</p> <p><i>Technical Group Comment:</i></p> <p>The ATG is seeking further clarity on these paragraphs to understand the implications, this may be an area that requires jurisdictional amendments/clarification.</p>	
<b>IAASB Timeline and impact on AUASB activities</b>	
<p>1. Expect IAASB vote to issue ED on ISRS 4400 for a 120 day consultation period. Expect consultation period to close end January 2019.</p> <p>2. If ED approved, late October / early November 2018 outreach by AUASB by way of roundtables in Sydney and Melbourne.</p> <p>3. Draft response of AUASB submission to IAASB exposure draft to be available for discussion at the December 2018 AUASB meeting.</p>	
<b>AUASB influencing activities</b>	
<p>ATG to prepare briefing notes for distribution to Australasian IAASB members and AUASB Chair – particularly to continue to highlight concerns in relation to professional judgement. AUASB Chair will be in attendance at the September 2018 IAASB meeting as an observer and will have the opportunity to express the Australian view to other non-Australasian IAASB members.</p>	
<b>Next steps / milestones for this project</b>	
Refer timeline above.	

## **Material Presented**

Agenda Paper 5.1.1	AUASB Board Meeting Summary Paper
Agenda Paper 5.1.2	ISRS 4400 Revised Requirements Clean
Agenda Paper 5.1.3	ISRS 4400 Revised Application Material Clean

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**Action Required**

No.	Action Item	Responsibility	Due Date
1.	The ATG is seeking comments / input from the AUASB on the matters described below as well as feedback on the proposed timetable / timeline	AUASB	12 September 2018

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## **ISRS 4400 (Revised) – Agreed-Upon Procedures Engagements (Requirements – CLEAN)**

### **Introduction**

#### **Scope of this ISRS**

1. This International Standard on Related Services (ISRS) deals with:
  - (a) The practitioner's responsibilities when engaged to perform agreed-upon procedures; and
  - (b) The form and content of the agreed-upon procedures report.
2. This ISRS applies to the performance of agreed-upon procedures on financial or non-financial information. (Ref: Para. A1)

#### *Relationship with ISQC 1<sup>1</sup>*

3. Quality control systems, policies and procedures are the responsibility of the firm. ISQC 1 applies to firms of professional accountants that perform audits and reviews of financial statements and other assurance and related services engagements, including agreed-upon procedures engagements. The provisions of this ISRS regarding quality control at the level of individual agreed-upon procedures engagements are premised on the basis that the firm is subject to ISQC 1 or requirements that are at least as demanding. (Ref: Para. A2-A7)

#### **The Agreed-Upon Procedures Engagement**

4. In an agreed-upon procedures engagement, the practitioner performs procedures agreed by the practitioner and the engaging party and reports the procedures performed and the related findings. The value of an agreed-upon procedures engagement performed in accordance with this ISRS results from:
  - (a) The practitioner's compliance with professional standards, including relevant ethical requirements; and
  - (b) Clear communication of the procedures performed and the related findings.

Engaging parties and intended users assess for themselves the procedures and findings reported by the practitioner and draw their own conclusions from the work performed by the practitioner.

6. In an agreed-upon procedures engagement, the practitioner does not perform an audit, review or other assurance engagement. The agreed-upon procedures engagement does not involve obtaining evidence for the purpose of expressing an opinion or conclusion in any form. The agreed-upon procedures engagement involves performing procedures agreed by the practitioner and the engaging party and clearly communicating in the agreed-upon procedures report the procedures performed and the related findings.

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<sup>1</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

7. Law, regulation and relevant ethical requirements establish responsibilities for the practitioner regarding fraud or an entity's non-compliance with laws and regulations<sup>2</sup>, including responsibilities to respond to matters that may indicate fraud or non-compliance with laws or regulations, or other matters that cast doubt on the integrity of the information relevant to the agreed-upon procedures engagement or indicate that such information may be misleading. The practitioner's responsibilities may include, for example, communicating with the engaging party, assessing the appropriateness of the engaging party's response, determining whether further action is needed, and ensuring adequate documentation on relevant actions.

### **Authority of this ISRS**

8. This ISRS contains the objectives of the practitioner in following the ISRS, which provide the context in which the requirements of this ISRS are set. The objectives are intended to assist the practitioner in understanding what needs to be accomplished in an agreed-upon procedures engagement.
9. This ISRS contains requirements, expressed using "shall," that are designed to enable the practitioner to meet the stated objectives.
10. In addition, this ISRS contains introductory material, definitions, and application and other explanatory material, that provide context relevant to a proper understanding of the ISRS.
11. The application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in this ISRS that assists in the application of the requirements.

### **Effective Date**

12. This ISRS is effective for agreed-upon procedures reports dated on or after [DATE].

### **Objectives**

13. In conducting an agreed-upon procedures engagement, the objectives of the practitioner are to:
  - (a) Agree the procedures to be performed with the engaging party;
  - (b) Perform the agreed-upon procedures; and
  - (c) Report the procedures performed and the related findings.

### **Definitions**

14. For purposes of this ISRS, the following terms have the meanings attributed below:
  - (a) Agreed-upon procedures – Procedures that have been agreed to by the practitioner and the engaging party.

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<sup>2</sup> Law, regulation or relevant ethical requirements may require the practitioner to perform additional procedures and take further actions. For example, the IESBA Code requires the practitioner to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed.

- (b) Agreed-upon procedures engagement – An engagement in which a practitioner is engaged to carry out those procedures to which the practitioner and the engaging party have agreed and to report the procedures performed and the related findings. The engaging party and intended users assess for themselves the procedures and findings reported by the practitioner and draw their own conclusions from them.
- (c) Engagement partner – The partner or other person in the firm who is responsible for the engagement and its performance, and for the agreed-upon procedures report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body. "Engagement partner" and "firm" are to be read as referring to their public sector equivalents when relevant.
- (d) Engaging party – The party(ies) that engages the practitioner to perform the agreed-upon procedures engagement and acknowledges the appropriateness of the procedures for the purpose of the engagement. (Ref: Para. A10)
- (e) Engagement team – All partners and staff performing the agreed-upon procedures engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes a practitioner's external expert engaged by the firm or a network firm.
- (f) Findings – Findings are the factual results of procedures performed. Findings are capable of being objectively verified and objectively described. Accordingly, references to findings in this ISRS exclude opinions or conclusions in any form as well as recommendations made by the practitioner. (Ref: Para. A10A)
- (g) Intended users – The individual(s) or organization(s), or group(s) that will use the agreed-upon procedures report.
- (h) Practitioner – The individual(s) conducting the agreed-upon procedures engagement (usually the engagement partner or other members of the engagement team, or, as applicable, the firm). When this ISRS expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "practitioner" is used.
- (i) Relevant ethical requirements – Principles of professional ethics and ethical requirements to which the firm and its personnel are subject when undertaking an agreed-upon procedures engagement, which ordinarily comprise the International Ethics Standards Board for Accountants' *International Code of Professional Ethics for Professional Accountants (Including International Independence Standards)* (IESBA Code) with respect to related services engagements, together with national requirements that are more restrictive.
- (j) Responsible party – The party(ies) responsible for the information on which the agreed upon procedures are performed.

## Requirements

### Conduct of an Agreed-Upon Procedures Engagement in Accordance with this ISRS

15. The practitioner shall have an understanding of the entire text of this ISRS, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.

### *Complying with Relevant Requirements*

16. The practitioner shall comply with each requirement of this ISRS unless a particular requirement is not relevant to the agreed-upon procedures engagement, for example if the circumstances addressed by the requirement do not exist in the engagement.
17. The practitioner shall not represent compliance with this ISRS in the agreed-upon procedures report unless the practitioner has complied with all requirements of this ISRS relevant to the agreed-upon procedures engagement.

### **Relevant Ethical Requirements**

18. The practitioner shall comply with relevant ethical requirements. (Ref: Para. A11-A13)

### **Professional Judgment**

19. The practitioner shall apply professional judgment taking into consideration the characteristics of an agreed-upon procedures engagement. (Ref: Para. A15-A17)

### **Engagement Level Quality Control**

20. The engagement partner shall take responsibility for:
  - a) The overall quality of the agreed-upon procedures engagement including, if applicable, procedures performed by a practitioner's expert; and (Ref: Para. A19)
  - b) The engagement being performed in accordance with the firm's quality control policies and procedures by:
    - (i) Following appropriate procedures regarding the acceptance and continuance of client relationships and engagements; (Ref: Para. A20)
    - (ii) Being satisfied that the engagement team, and any practitioner's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the agreed-upon procedures engagement;
    - (iii) Being alert for indications of non-compliance by members of the engagement team with relevant ethical requirements, and determining the appropriate actions if matters come to the engagement partner's attention indicating that members of the engagement team have not complied with relevant ethical requirements; (Ref: Para. A21)
    - (iv) Directing, supervising and performing the engagement in compliance with professional standards and applicable legal and regulatory requirements; and
    - (v) Taking responsibility for appropriate engagement documentation being maintained.

### **Engagement Acceptance and Continuance**

#### *Agreeing the Terms of the Engagement*

21. Before accepting an agreed-upon procedures engagement, the practitioner shall determine that the following conditions are present: (Ref: Para. A22, A28-A29)
  - (a) The engaging party acknowledges that the procedures to be performed are appropriate for the purpose of the engagement;



- (b) The agreed-upon procedures and findings can be described objectively, in terms that are clear, not misleading, and not subject to varying interpretations; and (Ref: Para. A23-A27)
  - (c) The practitioner is not aware of any facts or circumstances suggesting that the procedures the practitioner is being asked to agree are inappropriate for the purpose of the agreed-upon procedures engagement.
22. The practitioner shall agree the terms of the agreed-upon procedures engagement with the engaging party. These terms shall include the following:
- (a) Nature of the engagement, including a statement that the procedures to be performed do not constitute a reasonable or limited assurance engagement and accordingly, the practitioner does not express an opinion or assurance conclusion;
  - (b) Purpose of the engagement as identified by the engaging party;
  - (c) Acknowledgement by the engaging party that the procedures are appropriate for the purpose of the engagement;
  - (d) A statement as to whether the relevant ethical requirements with which the practitioner will comply in conducting the agreed-upon procedures engagement contain independence requirements, and whether the practitioner is expected to be, or not to be, independent;
  - (e) Identification of the addressee of the agreed-upon procedures report;
  - (f) The intended user(s) of the agreed-upon procedures report as identified by the engaging party; (Ref: Para. A30-A31)
  - (g) Identification of the information on which the agreed-upon procedures will be performed;
  - (h) Nature, timing and extent of the procedures to be performed; and
  - (i) Reference to the expected form and content of the agreed-upon procedures report.
23. Where the agreed-upon procedures are modified over the course of the engagement, the practitioner shall agree the amended terms of engagement with the engaging party to reflect the modified procedures. (Ref: Para. A33-A34)
24. The practitioner shall record the agreed terms of engagement in an engagement letter or other suitable form of written agreement. (Ref: Para. A35)

#### *Recurring Engagements*

25. On recurring agreed-upon procedures engagements, the practitioner shall evaluate whether the previous terms of engagement remain appropriate in the circumstances. If the practitioner concludes that the previous terms of engagement remain appropriate, the practitioner shall consider whether there is a need to remind the engaging party of the existing terms of engagement. (Ref: Para. A36)

#### **Performing the Agreed-Upon Procedures Engagement**

26. The practitioner shall perform the procedures as agreed in the terms of the engagement. (Ref: Para. A37-A38)

### Using the Work of a Practitioner's Expert

27. If the practitioner engages a practitioner's expert to perform any of the agreed-upon procedures, the practitioner shall: (Ref: Para. A39-A40)
- (a) Evaluate the expert's competence, capabilities and objectivity;
  - (b) Determine whether the nature, timing and extent of the procedures performed by the expert is consistent with the procedures agreed in the terms of the engagement; and
  - (c) Determine whether the findings reported by the expert adequately describe the result of the procedures performed.

### The Agreed-Up Upon Procedures Report

28. The agreed-upon procedures report shall be in writing.
29. The agreed-upon procedures report shall describe the agreed-upon procedures in sufficient detail to enable the user to understand the nature and the extent, and if relevant, the timing, of the work performed, and shall include: (Ref: Para. A43-A45)
- (a) A title that clearly indicates that the report is an agreed-upon procedures report;
  - (b) An addressee as indicated in the terms of the engagement;
  - (c) Identification of the information on which the procedures have been performed;
  - (d) A statement that the firm of which the practitioner is a member applies ISQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as ISQC 1. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements in law or regulation, applied that are at least as demanding as ISQC 1.
  - (e) A statement that the engagement was performed in accordance with ISRS 4400,
  - (f) If:
    - (i) The practitioner is independent in accordance with relevant ethical requirements containing independence requirements, a statement that the practitioner is independent of the entity in accordance with the relevant ethical requirements, and has fulfilled the practitioner's other ethical responsibilities in accordance with these requirements; or
    - (ii) The practitioner is not independent, and is not required by relevant ethical requirements to be independent, a statement that the relevant ethical requirements do not contain independence requirements and that the practitioner is not independent of the entity, and that the practitioner has fulfilled the practitioner's other ethical responsibilities in accordance with these requirements,

The statement shall also identify the jurisdiction of origin of the relevant ethical requirements or refer to the IESBA Code;
  - (g) A description of an agreed-upon procedures engagement stating that:

- (i) An agreed-upon procedures engagement involves the practitioner performing the procedures that have been agreed to by the practitioner and the engaging party, and reporting the findings based on the procedures performed.
  - (ii) The engaging party has acknowledged that the procedures are appropriate for the purpose of the engagement, and that the practitioner makes no representation regarding their appropriateness;
  - (h) A description of the procedures performed detailing the nature and extent, and if relevant, the timing, of each procedure;
  - (i) The findings from each procedure performed, including sufficient details on exceptions found;
  - (j) A statement that the procedures performed do not constitute a reasonable or limited assurance engagement and accordingly, the practitioner does not express an opinion or assurance conclusion;
  - (k) A statement that, had the practitioner performed additional procedures, or a reasonable or a limited assurance engagement, other matters might have come to the practitioner's attention which would have been reported;
  - (l) Identification of the purpose for which the agreed-upon procedures engagement is performed and a statement that the agreed-upon procedures report may not be suitable for another purpose; (Ref: Para. A42)
  - (m) The date of the agreed-upon procedures report;
  - (n) The practitioner's signature; and
  - (o) The location in the jurisdiction where the practitioner practices.
30. If the practitioner refers to the procedures performed by a practitioner's expert in the agreed-upon procedures report, the wording of that report shall not imply that the practitioner's responsibility for performing the procedures and reporting the findings is reduced because of the involvement of that expert. (Ref: Para. A46)
31. The practitioner shall date the agreed-upon procedures report on the date the practitioner has completed the agreed-upon procedures engagement in accordance with this ISRS.

#### **Undertaking an Agreed-Upon Procedures Engagement at the Same Time as another Engagement**

32. The agreed-upon procedures report shall be clearly distinguished from other engagement reports. (Ref: Para. A47)

#### **Documentation**

33. The practitioner shall include in the engagement documentation: (Ref: Para. A48)
- (a) The agreement of the engaging party on the procedures to be performed, including, if applicable, modifications to the procedures;
  - (b) The acknowledgement of the engaging party that the procedures performed are appropriate for the purpose of the engagement;
  - (c) The nature, timing and extent of the agreed-upon procedures performed; and

- (d) The findings resulting from the agreed-upon procedures performed.

(Last updated September 2018)

# AUASB Glossary

Issued by the **Auditing and Assurance Standards Board**



**Australian Government**

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**Auditing and Assurance Standards Board**

## **Obtaining a Copy of the AUASB Glossary**

This Glossary is available on the AUASB website: [www.auasb.gov.au](http://www.auasb.gov.au)

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## CONTENTS

PREFACE

AUTHORITY STATEMENT

AUASB GLOSSARY OF TERMS

## PREFACE

### Reasons for Issuing AUASB Glossary

The Auditing and Assurance Standards Board issues the *AUASB Glossary* under its powers described in section 227B of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act).

The AUASB is a non corporate Commonwealth entity of the Australian Government established under section 227A of the ASIC Act. Under section 227B of the ASIC Act, the AUASB may formulate pronouncements for other purposes.

The *AUASB Glossary* is not issued under the *Corporations Act 2001*.

### Main Features

The *AUASB Glossary* sets out terms defined, or used in, the suite of AUASB Standards.

The *AUASB Glossary* does not itself establish mandatory requirements for the performance of audit, review, other assurance or related services engagements.

The source(s) of terms in this Glossary is (are) indicated beside each term using the alpha-numeric prefix of the source standard(s) only. Where no source is indicated, a term has been retained in the Glossary because it provides useful guidance, although it may not be defined in the AUASB Standards.

A term may have more than one definition and should be read in the context of the AUASB Standard to which it applies. Such terms are notated with either bracketed words indicating the relevant standard – for example, “(in the context of ASQC 1) or, where there are several subject-matter specific definitions for the same term, a reference to all relevant sources is included – for example, “For subject matter specific definitions see: ASAE 3000 or ASAE 3150.”

### Operative Date

The *AUASB Glossary* (last updated September 2018) supersedes AUASB Glossary (October 2009) from the date of issuance.

The AUASB intends to update the *AUASB Glossary* periodically.

### Other Matters

When accounting terms have not been defined in the AUASB Standards, reference should be made to the *Glossary of Defined Terms* published by the Australian Accounting Standards Board (AASB).

The *Glossary of Defined Terms* is available on the AASB website: <http://www.aasb.gov.au/>



## **AUTHORITY STATEMENT**

The Auditing and Assurance Standards Board (AUASB) formulates *AUASB Glossary* pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001*.

12 September 2018

R Simnett  
Chair – AUASB

## AUASB GLOSSARY

Terms	Source(s)
<p><b>Access control</b> means procedures designed to restrict access to on-line terminal devices, programs and data. Access controls consist of “user authentication” and “user authorisation.” “User authentication” typically attempts to identify a user through unique logon identifications, passwords, access cards or biometric data. “User authorisation” consists of access rules to determine the computer resources each user may access. Specifically, such procedures are designed to prevent or detect:</p> <ul style="list-style-type: none"> <li>• Unauthorised access to on-line terminal devices, programs and data;</li> <li>• Entry of unauthorised transactions;</li> <li>• Unauthorised changes to data files;</li> <li>• The use of computer programs by unauthorised personnel; and</li> <li>• The use of computer programs that have not been authorised.</li> </ul>	
<p><b>Accounting estimate</b> means an approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. Where this Auditing Standard addresses only accounting estimates involving measurement at fair value, the term <i>fair value accounting estimates</i> is used.</p>	ASA 540
<p><b>Accounting records</b> mean the records of initial accounting entries and supporting records, such as cheques and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial report that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures</p>	ASA 500
<p><b>Activity</b> means a government or private sector provision of products or services, system, operation, function or programme which may be conducted within a single entity or across multiple entities, departments, agencies, joint ventures or other organisations, within a single jurisdiction or across multiple jurisdictions.</p>	ASAE 3500
<p><b>Addressees</b> mean the parties to whom the auditor addresses the comfort letter, and includes the requesting parties and the responsible party of the entity.</p>	ASRS 4450
<p><b>Agreed-upon procedures engagement</b> means an engagement in which an auditor is engaged to carry out those procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings. The recipients of the report form their own conclusions from the report by the auditor. The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures may misinterpret the results.</p>	ASRS 4400

Terms	Source(s)
<b>Analytical procedures</b> mean evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.	ASA 520 ASRE 2400
<b>Annual report</b> means a document, or combination of documents, prepared typically on an annual basis by management or those charged with governance in accordance with law, regulation or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial report. An annual report contains or accompanies the financial report and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters.	ASA 720
<b>Anomaly</b> means a misstatement or deviation that is demonstrably not representative of misstatements or deviations in a population.	ASA 530 ASAE 3150
<b>Applicable criteria</b> For subject-matter specific definitions see: ASAE 3410, ASAE 3420 or ASAE 3610.	
<b>Applicable financial reporting framework</b> means the financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of the financial report that is acceptable in view of the nature of the entity and the objective of the financial report, or that is required by law or regulation.  The term <i>fair presentation framework</i> means a financial reporting framework that requires compliance with the requirements of the framework and: <ul style="list-style-type: none"> <li>(a) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial report, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or</li> <li>(b) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial report. Such departures are expected to be necessary only in extremely rare circumstances.</li> </ul> The term <i>compliance framework</i> means a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (a) or (b) above. (see <i>Fair Presentation framework</i> ) For subject matter specific definitions see: ASA 600, ASRE 2410 or ASRS 4450.	ASA 200

Terms	Source(s)
<b><i>Application controls in information technology</i></b> means manual or automated procedures that typically operate at a business process level. Application controls can be preventative or detective in nature and are designed to ensure the integrity of the accounting records. Accordingly, application controls relate to procedures used to initiate, record, process and report transactions or other financial data.	
<b><i>Applied criteria</i></b>	
For subject matter specific definition see: ASA 810.	
<b><i>Appropriateness</i></b> (of audit evidence) means the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.	ASA 200 ASA 500
<b><i>Arm's length transaction</i></b> means a transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interests.	ASA 550
<b><i>Assertions</i></b> mean representations by management and those charged with governance, explicit or otherwise, that are embodied in the financial report, as used by the auditor to consider the different types of potential misstatements that may occur.	ASA 315
For subject matter specific definitions see: ASAE 3410 or ASAE 3610.	
<b><i>Assess</i></b> means analyse identified risks to conclude on their significance. "Assess," by convention, is used only in relation to risk. (also see <i>Evaluate</i> )	
<b><i>Association</i></b> (see <i>Auditor association with financial information</i> )	
<b><i>Assumptions</i></b> mean expectations made by the responsible party as to future events and actions expected to take place as at the date the prospective financial information is prepared and exclude hypothetical assumptions, unless otherwise stated.	ASAE 3450
<b><i>Assurance</i></b> (see <i>Reasonable assurance</i> )	
<b><i>Assurance engagement</i></b> means an engagement in which an assurance practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users, other than the responsible party, about the outcome of the evaluation or measurement of a subject matter against criteria. (see <i>Reasonable assurance engagement</i> and <i>Limited assurance engagement</i> ).	ASQC 1
For subject matter specific definition see: ASAE 3000 or ASAE 3610.	
<b><i>Assurance engagement risk</i></b> means the risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated.	
<b><i>Assurance practitioner</i></b> means an individual, firm, or other organisation, whether in public practice, industry and commerce, or the public sector conducting assurance engagements, or related services engagements (including engagements to perform agreed-upon procedures).	ASQC 1 ASA 102
For subject matter specific definitions see: ASA 220, ASAE 3000, ASAE 3500, ASAE 3610, ASRE 2400 or ASAS 4400.	

Terms	Source(s)
<b><i>Assurance practitioner's expert</i></b> means an individual or organisation possessing expertise in a field other than assurance, whose work in that field is used by the assurance practitioner to assist the assurance practitioner in obtaining sufficient appropriate evidence. An assurance practitioner's expert may be either an assurance practitioner's internal expert (who is a partner or staff, including temporary staff, of the assurance practitioner's firm or a network firm), or an assurance practitioner's external expert.	ASAE 3000 ASAE 3610
<b><i>Assurance report</i></b> means a written report prepared by an independent assurance practitioner that provides assurance on a single type of financial information (individual assurance report) or on multiple types of financial information (either a composite assurance report or separate assurance reports for each type of financial information). When prepared in connection with a fundraising it is often referred to as an "Independent Assurance Report" or "Investigating Accountant's Report".	ASAE 3450
<b><i>Assurance skills and techniques</i></b> mean those planning, evidence gathering, evidence evaluation, communication and reporting skills and techniques demonstrated by an assurance practitioner that are distinct from expertise in the underlying subject matter of any particular assurance engagement or its measurement or evaluation.	ASAE 3000 ASAE 3610
<b><i>Attestation engagement</i></b> means an assurance engagement in which a party other than the assurance practitioner measures or evaluates the underlying subject matter against the criteria. The outcome of that measurement or evaluation is often presented in a report or statement.	ASAE 3500
<b><i>Attestation engagement on compliance</i></b> means a reasonable or limited assurance engagement in which a party other than the assurance practitioner, being the responsible party or evaluator evaluates compliance with the compliance requirements. The outcome of that evaluation is provided in a Statement, which may either be available to the intended users or may be presented by the assurance practitioner in the assurance report. In an attestation engagement on compliance, the assurance practitioner's conclusion addresses whether the Statement is free from material misstatement. The assurance practitioner's conclusion may be phrased in terms of: (Ref: Para. 4(d), A4)	ASAE 3100
<ul style="list-style-type: none"> <li>(i). The compliance outcome and the criteria; or</li> <li>(ii). A Statement made by the appropriate party.</li> </ul>	
<b><i>Attestation engagement on controls</i></b> mean a reasonable or limited assurance engagement in which a party other than the assurance practitioner, being the responsible party or evaluator, evaluates the design against the control objectives, and, if included in the scope of the engagement, the description, implementation or operating effectiveness of controls, against the design. The outcome of that evaluation is provided in a Statement, which may either be available to the intended users or may be presented by the assurance practitioner in the assurance report. The assurance practitioner's conclusion may be phrased in terms of: (Ref: Para. A6)	ASAE 3150
<ul style="list-style-type: none"> <li>(i). the design, and/or description, implementation or operating effectiveness of controls and the control objectives; or</li> <li>(ii). the Statement of the responsible party or evaluator.</li> </ul>	

Terms	Source(s)
<p><b>AUASB Standards</b> mean standards issued by the AUASB, comprising:</p> <ul style="list-style-type: none"> <li>(a) Australian Auditing Standards which means the suite of auditing standards issued by the AUASB, comprising: <ul style="list-style-type: none"> <li>• Auditing Standards made under section 336 of the Corporations Act 2001;</li> <li>• ASA 805 Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement; and</li> <li>• ASA 810 Engagements to Report on Summary Financial Statements.</li> </ul> </li> <li>(b) Standards on Review Engagements;</li> <li>(c) Standards on Assurance Engagements; and</li> <li>(d) Standards on Related Services.</li> </ul>	<p>ASQC 1 ASAE 3450</p>
<p><b>Audit documentation</b> means the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “workpapers” are also sometimes used).</p>	<p>ASA 230</p>
<p><b>Audit engagement</b> (see <i>Reasonable assurance engagement</i>)</p>	
<p><b>Audit evidence</b> means information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial report and other information. For purposes of the Australian Auditing Standards:</p> <ul style="list-style-type: none"> <li>(i). Sufficiency of audit evidence is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor’s assessment of the risks of material misstatement and also by the quality of such audit evidence.</li> <li>(ii). Appropriateness of audit evidence is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor’s opinion is based.</li> </ul>	<p>ASA 200</p>
<p>For subject matter specific definitions see: ASA 500.</p>	
<p><b>Audit file</b> means one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.</p>	<p>ASA 230</p>
<p><b>Audit firm</b> (see <i>Firm</i>)</p>	
<p><b>Audit Opinion</b> (see <i>Modified opinion</i> and <i>Unmodified opinion</i>)</p>	
<p><b>Audit risk</b> means the risk that the auditor expresses an inappropriate audit opinion when the financial report is materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.</p>	<p>ASA 200</p>
<p><b>Audit sampling</b> (<i>sampling</i>) means the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.</p>	<p>ASA 530</p>
<p><b>Audited financial report</b> means a financial report audited by the auditor in accordance with Australian Auditing Standards, and from which the summary financial statements are derived.</p>	<p>ASA 810</p>

Terms	Source(s)
<p><b>Auditing Standards</b> mean auditing standards made under section 336 of the <i>Corporations Act 2001</i> (the “Act”), and include:</p> <ul style="list-style-type: none"> <li>(a) ASQC 1 <i>Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements</i>; and</li> <li>(b) ASRE 2410 <i>Review of a Financial Report Performed by the Independent Auditor of the Entity</i>.</li> </ul> <p>(see Australian Auditing Standards)</p>	ASA 101
<p><b>Auditor</b> means the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. Where an Auditing Standard expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term “engagement partner” rather than “auditor” is used. “Engagement partner” and “firm” are to be read as referring to their public sector equivalents where relevant.</p>	ASA 200 ASA 102
For subject matter specific definitions see: ASRE 2415 or ASRS 4450.	
<p><b>Auditor association with financial information</b> means an auditor is associated with financial information when the auditor attaches a report to that information or consents to the use of the auditor’s name in a professional connection.</p>	
<p><b>Auditor’s expert</b> means an individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor’s expert may be either an auditor’s internal expert (who is a partner or staff, including temporary staff, of the auditor’s firm or a network firm), or an auditor’s external expert. “Partner” and “firm” should be read as referring to their public sector equivalents where relevant.</p>	ASA 620
<p><b>Auditor’s point estimate or auditor’s range</b> means the amount, or range of amounts, respectively, derived from audit evidence for use in evaluating management’s point estimate.</p>	ASA 540
<p><b>Auditor’s range</b> (see <i>Auditor’s point estimate</i>)</p>	
<p><b>Auditor’s statement</b> means a statement made by the auditor that based on the procedures performed, nothing has come to the auditor’s attention that caused the auditor to believe that specified matters do not meet specified criteria.</p>	ASRS 4450
<p><b>Australian Accounting Standards</b> mean the Australian Accounting Standards issued by the Australian Accounting Standards Board.</p>	ASA 700 ASA 805

Terms	Source(s)
<p><b>Australian Auditing Standards</b> mean the suite of auditing standards issued by the AUASB, comprising:</p> <ul style="list-style-type: none"> <li>• Auditing Standards made under section 336 of the <i>Corporations Act 2001</i>;</li> <li>• ASA 805 <i>Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement</i>; and</li> <li>• ASA 810 <i>Engagements to Report on Summary Financial Statements</i>.</li> </ul> <p>(see <i>Auditing Standards</i>)</p>	<p>ASA 101 ASA 220</p>
<p><b>Australian Water Accounting Standards</b> (in the context of ASAE 3610) means water accounting standards issued by the Bureau of Meteorology in accordance with its functions under the Commonwealth Water Act 2007.</p>	<p>ASAE 3610</p>
<p><b>Base financial information</b> means financial information that is used as the starting point for the application of pro forma adjustments<sup>4</sup> by the responsible party. Base financial information is ordinarily historical in nature, however, it can also be prospective (for example a profit forecast). It may or may not have been previously audited or reviewed. Base financial information may also be referred to as unadjusted or source financial information.</p>	<p>ASAE 3450</p>
<p><b>Base year</b> a specific year or an average over multiple years against which an entity's emissions are compared over time.</p>	<p>ASAE 3410</p>
<p><b>Bring down comfort letter</b> means a letter prepared and issued by the auditor subsequent to the issuance of the initial comfort letter, that updates and reaffirms the results of the specified procedures described in that comfort letter as at a certain date.</p>	<p>ASRS 4450</p>
<p><b>Business risk</b> means a risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.</p>	<p>ASA 315</p>
<p><b>Cap and trade</b> means a system that sets overall emissions limits, allocates emissions allowances to participants, and allows them to trade allowances and emission credits with each other.</p>	<p>ASAE 3410</p>
<p><b>Carve-out method</b></p> <p>For subject matter specific definitions see: ASAE 3150 or ASAE 3402.</p>	
<p><b>Change period</b> means the period specified by the requesting parties ending on the cut-off date and begins for balance sheet items, immediately after the date of the latest balance sheet, and for profit and loss items, immediately after the latest period for which such items are included in, or incorporated by reference, in the offering document and does not extend beyond the day before the date of the end of the entity's next financial reporting period.</p>	<p>ASRS 4450</p>
<p><b>Closing date</b> means the date on which the issuer of the securities or selling security holder delivers the securities to the underwriter in exchange for the proceeds of the offering.</p>	<p>ASRS 4450</p>



Terms	Source(s)
<b>Comfort letter</b> means a letter issued by an auditor in accordance with this ASRS under the terms of the engagement letter to requesting parties in relation to an entity's financial information related to, and/or included in an offering document.	ASRS 4450
<b>Company limited by guarantee</b> means a company limited by guarantee whose obligations are set out in section 285A of the Act.	ASRE 2415
<b>Comparative financial reports</b> mean comparative information where amounts and other disclosures for the prior period are included for comparison with the financial report of the current period but, if audited, are referred to in the auditor's opinion. The level of information included in those comparative financial reports is comparable with that of the financial report of the current period.	ASA 710
<b>Comparative information</b> means the amounts and disclosures included in the financial report in respect of one or more prior periods in accordance with the applicable financial reporting framework.	ASA 710
For subject matter specific definitions see: ASAE 3410 or ASAE 3610.	
<b>Comparison date and comparison period</b> mean the dates as of which, and periods for which, data at the cut-off date and data for the change period are to be compared.	ASRS 4450
<b>Compensating control</b> means a control which makes up for a deficiency in another control in mitigating the risks that threaten achievement of a control objective.	ASAE 3150
<b>Complementary user entity controls</b> mean controls that the service organisation assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives, are identified in the description of its system.	ASA 402
For subject matter specific definitions see: ASAE 3150 or ASAE 3402.	
<b>Complete set of financial statements</b> mean financial statements and related notes as determined by the requirements of the applicable financial reporting framework. For example, a complete set of financial statements as described in Accounting Standard AASB 101 <i>Presentation of Financial Statements</i> <sup>1</sup> includes:	ASA 200
<ul style="list-style-type: none"> <li>(a) a statement of financial position as at the end of the period;</li> <li>(b) a statement of comprehensive income for the period;</li> <li>(c) a statement of changes in equity for the period;</li> <li>(d) a statement of cash flows for the period; and</li> <li>(e) notes, comprising a summary of significant accounting policies and other explanatory information.</li> </ul>	
For subject matter specific definition see: ASRE 2400.	
<b>Compliance</b> means adherence by the entity to the requirements as measured by the suitable criteria.	ASAE 3100
<b>Compliance activity</b> ( <i>subject matter</i> or underlying subject matter) means the activity that is undertaken to meet the compliance requirement(s).	ASAE 3100

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<sup>1</sup> See ASA 101 *Presentation of Financial Statements*, paragraph 10.

Terms	Source(s)
<b>Compliance engagement</b> means an assurance engagement in which an assurance practitioner expresses a conclusion, after evaluating an entity's compliance with the requirements.	ASAE 3100
<b>Compliance framework</b> (see <i>Applicable financial reporting framework</i> and <i>General purpose framework</i> )	
For subject matter specific definitions see: ASA 200 or ASAE 3100.	
<b>Compliance outcome</b> ( <i>subject matter information</i> ) means the outcome of the evaluation of the underlying subject matter (compliance activity) against the compliance requirements, using the criteria. The compliance outcome is the Statement of the responsible party or evaluator in an attestation engagement on compliance, or the assurance practitioner's conclusion in a direct engagement on compliance, providing the outcome of their evaluation.	ASAE 3100
<b>Compliance requirement(s)</b> means the requirements established in law, regulations, other statutory requirements (e.g. ASIC Class Orders and Regulatory Guides and APRA Prudential Standards), contractual arrangements, ministerial directives, industry or professional obligations or internally via entity policies, procedures and frameworks.	ASAE 3100
<b>Component</b> means an entity or business activity for which group or component management prepares financial information that should be included in the group financial report.	ASA 600
<b>Component auditor</b> means an auditor who, at the request of the group engagement team, performs work on financial information related to a component for the group audit.	ASA 600
<b>Component management</b> means management, or those charged with governance, responsible for the preparation of the financial information of a component.	ASA 600
<b>Component materiality</b> means the materiality level for a component determined by the group engagement team.	ASA 600
<b>Components of control</b> means the integrated components which comprise the system of control, as defined by the control framework applied.	ASAE 3150
<b>Computer-assisted audit techniques</b> mean applications of auditing procedures using the computer as an audit tool (also known as CAATs).	
<b>Concise financial report</b> means a financial report for the year referred to in the <i>Corporations Act 2001</i> drawn up in accordance with accounting standard AASB 1039 <i>Concise Financial Reports</i> .	
<b>The consolidation process</b> includes:	ASA 600
<ul style="list-style-type: none"> <li>(a) The recognition, measurement, presentation, and disclosure of the financial information of the components in the group financial report by way of consolidation, proportionate consolidation, or the equity or cost methods of accounting; and</li> <li>(b) The aggregation in combined financial reports of the financial information of components that have no parent but are under common control.</li> </ul>	
<b>Control activities</b> mean the actions established by policies and procedures that help ensure that management directives to mitigate the risks to the achievement of objectives are carried out.	ASAE 3610

Terms	Source(s)
<b>Control environment</b> means the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment is a component of internal control.	ASAE 3610
<b>Control objective</b> means the aim or purpose of a particular aspect of controls. Control objectives relate to risks that controls seek to mitigate and may be categorised by the framework applied, such as operational (economy, effectiveness and efficiency), reporting (statutory or management, financial or non-financial) or compliance (adherence to laws and regulations or contractual obligations).	ASAE 3150
For subject matter specific definition see: ASAE 3402.	
<b>Control risk</b> (see <i>Risk of material misstatement</i> )	
<b>Controls at a subservice organisation</b> means controls at a subservice organisation to provide reasonable assurance about the achievement of a control objective.	ASAE 3402
<b>Controls at the service organisation</b> means controls over the achievement of a control objective that is covered by the service auditor's assurance report.	ASAE 3402
<b>Corporate fundraising</b> (" <i>fundraising</i> ") means any transaction involving shares, debentures, units or interests in a management investment scheme undertaken to raise debt or equity funds, or issue equity, and/or offer and/or respond to an offer of, cash and/or scrip consideration to effect a transaction through the issuance of a public or non-public document. It includes initial public offerings, fundraisings <sup>5</sup> , takeovers, schemes of arrangement or other corporate restructures.	ASAE 3450
<b>Corporate governance</b> (see <i>Governance</i> )	
<b>Corresponding figures</b> mean comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial report, and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as "current period figures"). The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.	ASA 710
<b>Criteria</b> means the benchmarks used to measure or evaluate the underlying subject matter. The "applicable criteria" are the criteria used for the particular engagement.	ASAE 3000 ASAE 3150 ASAE 3402
For subject matter specific definitions see: ASAE 3100, ASAE 3500 or ASAE 3610.	
<b>Cross-border offering</b> means an offering or listing that occurs in a jurisdiction other than the entity's domicile, and which may or may not occur concurrently in the entity's domicile.	ASRS 4450
<b>Cut-off date</b> means the date to which certain procedures performed on change period financial information, as described in the comfort letter, are to relate.	ASRS 4450
<b>Date of approval of the financial report</b> means the date on which all the statements that comprise the financial report, including the related notes, have been prepared and those with the recognised authority have asserted that they have taken responsibility for that financial report.	ASA 560
<b>Date of report</b> means the date the assurance practitioner signs the report.	ASQC 1

Terms	Source(s)
<b><i>Date of the auditor's report</i></b> means the date the auditor dates the report on the financial report in accordance with ASA 700.	ASA 560
<b><i>Date of the financial report</i></b> means the date of the end of the latest period covered by the financial report.	ASA 560
<b><i>Date the financial report is issued</i></b> means the date that the auditor's report and audited financial report are made available to third parties.	ASA 560
<b><i>Deficiency in design of controls</i></b> mean an inadequacy or omission in the design of a control/s that, in the assurance practitioner's professional judgement, means the control/s is not designed suitably to mitigate the risks that threaten achievement of the identified control objectives.	ASAE 3150
<b><i>Deficiency in implementation of controls</i></b> mean instances where a control was not implemented as designed that, in the assurance practitioner's professional judgement, mean the control/s, once in operation, may not operate effectively as designed to achieve the identified control objectives.	ASAE 3150
<b><i>Deficiency in internal control</i></b> means:	ASA 265
(a) A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial report on a timely basis; or	
(b) A control necessary to prevent, or detect and correct, misstatements in the financial report on a timely basis is missing.	
<b><i>Description of the system</i></b> means a document prepared by the responsible party and provided to users, if included in the scope of the engagement, describing the entity's system, within which the controls to be concluded upon operate, including identification of: the functions or services covered; the period or date to which the description relates; control objectives and details of, or reference to documentation detailing, the controls designed to achieve those objectives. The entity's functions or services may be identified by geographic, operational or functional boundaries. A description of the system is distinct from documentation prepared by the responsible party or assurance practitioner, as the description is part of the subject matter of the engagement, which, if included in the scope of the engagement, is made available to users and concluded upon by the assurance practitioner. A description may be included in the scope of an attestation or direct engagement, however in a direct engagement no attestation is provided by the responsible party or evaluator with respect to whether the description is fairly presented.	ASAE 3150
<b><i>Detection risk</i></b> means the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.	ASA 200
<b><i>Deviation in operating effectiveness of controls</i></b> mean instances where a control was not operating as designed.	ASAE 3150
<b><i>Different elements of prospective financial information</i></b> means:	ASAE 3450
(i). the assumptions used in the preparation of the prospective financial information; (element 1)	
(ii). the stated basis of preparation and the assumptions referred to in (i) above; (element 2) and	
(iii).its reasonableness (element 3).	

Terms	Source(s)
<b>Direct assistance</b> means the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.	ASA 610
<b>Direct controls</b> mean controls which directly address the risks of a control objective not being achieved, by detecting, preventing or correcting a failure to achieve a control objective on a timely basis.	ASAE 3150
<b>Direct engagement on compliance</b> means a reasonable or limited assurance engagement in which the assurance practitioner evaluates whether the compliance requirements have been met. The compliance outcome of the assurance practitioner's evaluation (the subject matter information) is expressed in the assurance practitioner's conclusion.	ASAE 3100
<b>Direct engagement on controls</b> mean a reasonable or limited assurance engagement in which the assurance practitioner evaluates the design of the controls against the control objectives, and, if included in the scope of the engagement, the description, implementation and/or operating effectiveness of controls against the design. The outcome of the assurance practitioner's evaluation (the subject matter information) is expressed in the assurance practitioner's conclusion.	ASAE 3150
<b>Direct engagement on performance</b> means a reasonable assurance engagement in which the assurance practitioner evaluates the activity's performance against the identified criteria. The outcome of the assurance practitioner's evaluation is expressed in the assurance practitioner's conclusion.	ASAE 3500
<b>Document</b> means a public document or non-public document related to a corporate fundraising or other document containing prospective financial information.	ASAE 3450
<b>Domestic offering</b> means a securities offering that occurs in Australia.	ASRS 4450
<b>Economy</b> means the performance principle relating to the minimisation of the costs of resources, within the operational requirements of timeliness and availability of required quantity or quality.	ASAE 3500
<b>Effectiveness</b> means performance principle relating to the extent to which the intended objectives at a program or entity level are achieved.	ASAE 3500
<b>Efficiency</b> means performance principle relating to the minimisation of inputs employed to deliver the intended outputs in terms of quality, quantity and timing.	ASAE 3500
<b>Element</b> (see <i>Element of a financial statement</i> )	
<b>Element of a financial statement</b> means an element, account or item of a financial statement.	ASA 805
<b>Emissions</b> mean the GHGs that, during the relevant period, have been emitted into the atmosphere or would have been emitted into the atmosphere had they not been captured and channelled into a sink. Emissions can be categorised as: <ul style="list-style-type: none"> <li>• Direct emissions (also known as Scope 1 emissions), which are emissions from sources that are owned or controlled by the entity.</li> <li>• Indirect emissions, which are emissions that are a consequence of the activities of the entity, but which occur at</li> </ul>	ASAE 3410

Terms	Source(s)
<p>sources that are owned or controlled by another entity. Indirect emissions can be further categorised as:</p> <ul style="list-style-type: none"> <li>○ Scope 2 emissions, which are emissions associated with energy that is transferred to and consumed by the entity.</li> <li>○ Scope 3 emissions, which are all other indirect emissions.</li> </ul>	
<p><b>Emissions deduction</b> means Any item included in the entity’s GHG statement that is deducted from the total reported emissions, but which is not a removal; it commonly includes purchased offsets, but can also include a variety of other instruments or mechanisms such as performance credits and allowances that are recognised by a regulatory or other scheme of which the entity is a part.</p>	ASAE 3410
<p><b>Emissions factor</b> means a mathematical factor or ratio for converting the measure of an activity (for example, litres of fuel consumed, kilometres travelled, the number of animals in husbandry, or tonnes of product produced) into an estimate of the quantity of GHGs associated with that activity.</p>	ASAE 3410
<p><b>Emissions trading scheme</b> means a market-based approach used to control greenhouse gases by providing economic incentives for achieving reductions in the emissions of such gases.</p>	ASAE 3410
<p><b>Emphasis of Matter paragraph</b> means a paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the financial report that, in the auditor’s judgement, is of such importance that it is fundamental to users’ understanding of the financial report.</p>	ASA 706
<p><b>Engagement circumstances</b> means the broad context defining the particular engagement, which includes: the terms of the engagement; whether it is a reasonable assurance engagement or a limited assurance engagement, the characteristics of the underlying subject matter; the measurement or evaluation criteria; the information needs of the intended users; relevant characteristics of the responsible party, the measurer or evaluator, and the engaging party and their environment; and other matters, for example events, transactions, conditions and practices, that may have a significant effect on the engagement.</p>	ASAE 3000
<p><b>Engagement documentation</b> means the record of work performed, relevant evidence obtained, and conclusions the assurance practitioner reached (terms such as “working papers” or “<u>workpapers</u>” are sometimes used).</p>	ASQC 1
<p><b>Engagement letter</b> means the written terms of an engagement in the form of a letter.</p>	
<p><b>Engagement partner</b> means the partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body. “Engagement partner” should be read as referring to a public sector equivalent where relevant.</p>	ASQC 1 ASA 220
<p><b>Engagement quality control review</b> means a process designed to provide an objective evaluation, on or before the date of the report, of the significant judgements the engagement team made and the conclusions it reached in formulating the report. The engagement quality control review process is for</p>	ASQC 1 ASA 220

Terms	Source(s)
audits of financial reports of listed entities and those other engagements, if any, for which the firm has determined an engagement quality control review is required.	
<b>Engagement quality control reviewer</b> means a partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgements the engagement team made and the conclusions it reached in formulating the report.	ASQC 1 ASA 102 ASA 220
<b>Engagement risk</b> means the risk that the assurance practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated.	ASAE 3000 ASAE 3500 ASRE 2400
For subject matter specific definitions see: ASAE 3610.	
<b>Engagement team</b> (in the context of ASQC 1) means all partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes an auditor's external expert engaged by the firm or by a network firm.	ASQC 1 ASA 220
For subject matter specific definitions see: ASAE 3000 or ASAE 3610.	
<b>Engaging party</b> means the party (ies) that engages the assurance practitioner to perform the assurance engagement.	ASAE 3000 ASAE 3100 ASAE 3150 ASAE 3610
For subject matter specific definitions see: ASAE 3450, ASAS 3500 or ASRS 4400.	
<b>Enquiry</b> (in the context of ASRE 2400) means enquiry consists of seeking information of knowledgeable persons from within or outside the entity.	ASRE 2400
<b>Entity</b> subject matter specific definitions see: ASAE 3100, ASAE 3410, ASAE 3450 or ASRS 4450.	
<b>Entity's risk assessment process</b> means a component of internal control that is the entity's process for identifying business risks relevant to financial reporting objectives and deciding about actions to address those risks, and the results thereof.	
<b>Entity's system (or the system)</b> means the policies and procedures designed and implemented by the entity to provide the functions or services covered by the assurance practitioner's report, including the control objectives which address the overall objectives relevant to those functions or services and the controls designed to mitigate the risks that threaten achievement of those objectives.	ASAE 3150
<b>Environmental risk</b> means in certain circumstances, factors relevant to the assessment of inherent risk for the development of the overall audit plan may include the risk of material misstatement of the financial statements due to environmental matters.	
<b>Error</b> means an unintentional misstatement in a financial report, including the omission of an amount or a disclosure.	
<b>Estimation uncertainty</b> means the susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement.	ASA 540

Terms	Source(s)
<b>Evaluate</b> means identify and analyse the relevant issues, including performing further procedures as necessary, to come to a specific conclusion on a matter. “Evaluation,” by convention, is used only in relation to a range of matters, including evidence, the results of procedures and the effectiveness of management’s response to a risk. (also see <i>Assess</i> )	
<b>Event(s) or transaction(s)</b> means underlying event(s) or transaction(s) that is (are):	ASAE 3450
<ul style="list-style-type: none"> <li>(i). primarily the subject of the document; or</li> <li>(ii). not the subject of the document but the effect(s) of which have been reflected in the financial information.</li> </ul>	
<b>Evidence</b> means information used by the assurance practitioner in arriving at the assurance practitioner’s conclusion. Evidence includes both information contained in relevant information systems, if any, and other information. For purposes of the ASAEs:	ASAE 3000
<ul style="list-style-type: none"> <li>(i). Sufficiency of evidence is the measure of the quantity of evidence.</li> <li>(ii). Appropriateness of evidence is the measure of the quality of evidence</li> </ul>	
<b>Exception</b> means a response that indicates a difference between information requested to be confirmed, or contained in the entity’s records, and information provided by the confirming party.	ASA 505
<b>Experienced auditor</b> means an individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of:	ASA 230
<ul style="list-style-type: none"> <li>(a) Audit processes;</li> <li>(b) Australian Auditing Standards and applicable legal and regulatory requirements;</li> <li>(c) The business environment in which the entity operates; and</li> <li>(d) Auditing and financial reporting issues relevant to the entity’s industry.</li> </ul>	
<b>Expert</b> (see <i>Auditor’s expert</i> and <i>Management’s expert</i> )	
<b>Expertise</b> means skills, knowledge and experience in a particular field.	ASA 620
<b>External confirmation</b> means audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.	ASA 505
<b>Fair presentation framework</b> (see <i>Applicable financial reporting framework</i> and <i>General purpose framework</i> )	ASA 200
<b>Financial forecast</b> means financial information of a predictive character prepared based on assumptions made by the entity as to future events, expected to take place on the dates described, and the actions expected to be taken at the date the financial information is prepared.	ASRS 4450
<b>Financial information</b> means information of a financial nature prepared by the responsible party in the form of:	ASAE 3450
<ul style="list-style-type: none"> <li>(i). base financial information;</li> <li>(ii). historical financial information;</li> </ul>	



Terms	Source(s)
<p>(iii).pro forma historical financial information;</p> <p>(iv).prospective financial information; or</p> <p>(v). a pro forma forecast.</p> <p>For subject matter specific definition see: ASRE 4450.</p> <p><b>Financial report</b> means, for the purpose of the <i>Corporations Act 2001</i>, financial statements for the year or the half-year, and notes to the financial statements, and the directors' declaration about the statements and notes.</p> <p><i>Financial report</i> means, for purposes other than the <i>Corporations Act 2001</i>, a complete set of financial statements and an assertion statement by those responsible for the financial report.</p>	<p>ASA 200</p> <p>ASA 700</p>
<p>For subject matter specific definitions see: ASRE 2400, ASRE 2410 or ASRE 2415.</p> <p><b>Financial statements</b> mean a structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with a financial reporting framework. The term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement. Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement, or in the notes, or incorporated therein by cross-reference.</p> <p>For subject matter specific definitions see: ASA 800 or ASRE 2400.</p> <p><b>Firm</b> means a sole practitioner, partnership or corporation or other entity of assurance practitioners. Firm should be read as referring to a public sector equivalent where relevant.</p>	<p>ASA 200</p> <p>ASQC 1</p> <p>ASA 102</p> <p>ASA 220</p> <p>ASAE 3000</p> <p>ASAE 3100</p> <p>ASAE 3150</p> <p>ASAE 3610</p>
<p><b>Forecast</b> (see <i>Prospective financial information</i>)</p> <p><b>Fraud</b> means an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.</p> <p>For subject matter specific definition see: ASAE 3610.</p> <p><b>Fraud risk factors</b> mean events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.</p>	<p>ASA 240</p> <p>ASAE 3150</p> <p>ASAE 3410</p> <p>ASA 240</p> <p>ASAE 3150</p>

Terms	Source(s)
<b><i>Fraudulent financial reporting</i></b> means financial reporting involving intentional misstatements, including omissions of amounts or disclosures in a financial report, to deceive financial report users.	
<b><i>Further procedures</i></b> mean procedures performed in response to assessed risks of material misstatement, including tests of controls (if any), tests of details and analytical procedures.	ASAE 3410 ASAE 3610
<b><i>General IT controls</i></b> mean policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. General IT controls commonly include controls over data center and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development, and maintenance.	
<b><i>General purpose financial report</i></b> means a financial report prepared in accordance with a general purpose framework.	ASA 700
<b><i>General purpose financial statements</i></b> mean financial statements prepared in accordance with a general purpose framework.	ASRE 2400
<b><i>General purpose framework</i></b> means a financial reporting framework designed to meet the common financial needs of a wide range of users. The financial reporting framework may be a fair presentation framework or a compliance framework. (see <i>Applicable financial reporting framework</i> )	ASA 700
The term “fair presentation framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:	
<ul style="list-style-type: none"> <li>(i). Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or</li> <li>(ii). Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.</li> </ul>	
The term “compliance framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.	
For subject matter specific definition see: ASRE 2400.	
<b><i>General purpose water accounting report</i></b> means a water accounting report intended to meet the information needs common to users who are unable to command the preparation of water accounting reports tailored to satisfy their information needs. A general purpose water accounting report is prepared in accordance with Australian Water Accounting Standards. AWAS 1 states that a general purpose water accounting report comprises the water accounting statements, accompanying note disclosures, accountability statement and contextual statement. This Standard deals with assurance engagements to report on the water accounting statements, note disclosures and accountability statement only. It does not cover the contextual statement, which is not subject to assurance. Accordingly, where appropriate in this Standard, the term “general purpose water accounting report” is to be read as meaning those components that are covered by the assurance engagement.	ASAE 3610

Terms	Source(s)
<b>GHG statement</b> means a statement setting out constituent elements and quantifying an entity's GHG emissions for a period (sometimes known as an emissions inventory) and, where applicable, comparative information and explanatory notes including a summary of significant quantification and reporting policies. An entity's GHG statement may also include a categorised listing of removals or emissions deductions. Where the engagement does not cover the entire GHG statement, the term "GHG statement" is to be read as that portion that is covered by the engagement. The GHG statement is the "subject matter information" of the engagement.	ASA 240 ASAE 3410
<b>Governance</b> means the role of person(s) or organisation(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.	
<b>Greenhouse gases (GHGs)</b> means carbon dioxide (CO <sub>2</sub> ) and any other gases required by the applicable criteria to be included in the GHG statement, such as: methane; nitrous oxide; sulfur hexafluoride; hydrofluorocarbons; perfluorocarbons; and chlorofluorocarbons. Gases other than carbon dioxide are often expressed in terms of carbon dioxide equivalents (CO <sub>2</sub> -e).	ASAE 3410
<b>Group</b> means all the components whose financial information is included in the group financial report. A group always has more than one component.	ASA 600
<b>Group audit</b> means the audit of a group financial report.	ASA 600
<b>Group audit opinion</b> means the audit opinion on the group financial report.	ASA 600
<b>Group engagement partner</b> means the partner or other person in the firm who is responsible for the group audit engagement and its performance, and for the auditor's report on the group financial report that is issued on behalf of the firm. Where joint auditors conduct the group audit, the joint engagement partners and their engagement teams collectively constitute the group engagement partner and the group engagement team. This Auditing Standard does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor.	ASA 600
<b>Group engagement team</b> means partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial report.	ASA 600
<b>Group financial report</b> means a financial report that includes the financial information of more than one component. The term "group financial report" also refers to combined financial reports aggregating the financial information prepared by components that have no parent but are under common control.	ASA 600
<b>Group management</b> means management, or those charged with governance, responsible for the preparation of the group financial report.	ASA 600
<b>Group-wide controls</b> mean controls designed, implemented and maintained by group management over group financial reporting.	ASA 600
<b>Historical financial information</b> means information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.	ASA 200 ASAE 3000
For subject matter specific definition see: ASAE 3450.	

Terms	Source(s)
<p><b>Historical financial information, other than a financial report</b> (in the context of ASRE 2405) includes:</p> <ul style="list-style-type: none"> <li>(a) Specific components, elements, accounts or items of a financial report, such as: <ul style="list-style-type: none"> <li>(i). A single financial statement, for example, an income statement or balance sheet.</li> <li>(ii). Accounts receivable.</li> <li>(iii). Impairment of asset accounts.</li> <li>(iv). Inventory.</li> <li>(v). The liability for accrued benefits of a defined benefits plan.</li> <li>(vi). The recorded value of identified intangible assets.</li> <li>(vii). Pro-forma historical financial information and adjustments.</li> <li>(viii). The liability for “incurred but not reported” claims in an insurance portfolio, including related explanatory notes.</li> </ul> </li> <li>(b) Other information derived from financial records, such as: <ul style="list-style-type: none"> <li>(i). A schedule of externally managed assets and income of a private pension plan, including related explanatory notes.</li> <li>(ii). A schedule of net tangible assets, including related explanatory notes.</li> <li>(iii). A schedule of disbursements in relation to a leased property, including related explanatory notes.</li> <li>(iv). A schedule of profit participation or employee bonuses, including related explanatory notes.</li> </ul> </li> <li>(c) Financial statements prepared in accordance with a financial reporting framework that is not designed to achieve fair presentation, such as condensed financial statements and an entity’s internal management accounts.</li> </ul>	ASRE 2405
<p><b>Hypothetical assumptions</b> mean assumptions made by the responsible party in preparing prospective financial information in the form of a projection about future events and management actions which may not necessarily be expected to take place or that may be expected to take place, and may not be based on reasonable grounds.</p>	ASAE 3450
<p><b>Implementation</b> means the process of putting controls into effect by deployment or roll-out of controls to enable their operation as designed.</p>	ASAE 3150
<p><b>Inclusive method</b> means method of dealing with the services provided by a subservice organisation, whereby the service organisation’s description of its system includes the nature of the services provided by a subservice organisation, and that subservice organisation’s relevant control objectives and related controls are included in the service organisation’s description of its system and in the scope of the service auditor’s engagement.</p> <p>For subject matter specific definition see: ASAE 3150.</p>	ASAE 3402
<p><b>Indirect controls</b> mean controls which do not directly address the risks of a control objective not being achieved, but have an impact on the effectiveness</p>	ASAE 3150

Terms	Source(s)
of direct controls in detecting, preventing or correcting a failure to achieve a control objective on a timely basis.	
<b>Information system relevant to financial reporting</b> means a component of internal control that includes the financial reporting system, and consists of the procedures and records established to initiate, record, process and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities and equity.	
<b>Inherent risk</b> (see <i>Risk of material misstatement</i> )	
<b>Initial assurance engagement</b> means an engagement in which either:	ASAE 3610
(i). the general purpose water accounting report has been prepared and assured for the first time;	
(ii). the general purpose water accounting report for the prior period was not assured; or	
(iii). the general purpose water accounting report for the prior period was assured by a predecessor assurance practitioner.	
<b>Initial audit engagement</b> means an engagement in which either:	ASA 510
(a) The financial report for the prior period was not audited; or	
(b) The financial report for the prior period was audited by a predecessor auditor.	
<b>Inspection</b> means in relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.	ASQC 1 ASA 220
For subject matter specific definition see: ASA 500.	
<b>Intended users</b> mean the individual(s) or organisation(s), or group(s) thereof that the practitioner expects will use the assurance report. In some cases, there may be intended users other than those to whom the assurance report is addressed.	ASAE 3000 ASAE 3100 ASAE 3150
For subject matter specific definitions see: ASAE 3500 or ASRS 4400.	
<b>Interim financial information or statements</b> mean financial information (which may be less than a complete set of financial statements as defined above) issued at interim dates (usually half-yearly or quarterly) in respect of a financial period.	
<b>Interim financial report</b> means a financial report that is prepared in accordance with an applicable financial reporting framework <sup>2</sup> for a period that is shorter than the entity's financial year.	ASRE 2410
<b>Internal audit function</b> means a function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.	ASA 610 ASAE 3000 ASAE 3100 ASAE 3150 ASAE 3402

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<sup>2</sup> See for example, Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001*.

Terms	Source(s)
<p><b>Internal auditors</b> mean those individuals who perform the activities of the internal audit function. Internal auditors may belong to an internal audit department or equivalent function.</p> <p>For subject matter specific definition see: ASAE 3150.</p>	<p>ASA 610 ASAE 3402</p>
<p><b>Internal control</b> means the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control.</p> <p>For subject matter specific definition see: ASAE 3150.</p>	<p>ASA 315</p>
<p><b>International Financial Reporting Standards</b> mean the International Financial Reporting Standards issued by the International Accounting Standards Board.</p>	<p>ASA 700</p>
<p><b>International Public Sector Accounting Standards</b> mean the International Public Sector Accounting Standards issued by the International Public Sector Accounting Standards Board.</p>	<p>ASA 700</p>
<p><b>Investigate</b> means to enquire into matters arising from other procedures to resolve them.</p>	
<p><b>IT environment</b> means the policies and procedures that the entity implements and the IT infrastructure (hardware, operating systems, etc.) and application software that it uses to support business operations and achieve business strategies.</p>	
<p><b>Key audit matters</b> mean those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial report of the current period. Key audit matters are selected from matters communicated with those charged with governance.</p>	<p>ASA 701</p>
<p><b>Lead assurance practitioner</b> means The person in the firm who is responsible for the engagement and its performance, and for the assurance report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body. The "lead assurance practitioner" should be read as referring to its public sector equivalents where relevant.</p>	<p>ASAE 3000 ASAE 3610</p>
<p><b>Limited assurance</b> means the level of assurance obtained where engagement risk is reduced to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for expressing a conclusion in accordance with this ASRE. The combination of the nature, timing and extent of evidence gathering procedures is at least sufficient for the assurance practitioner to obtain a meaningful level of assurance. To be meaningful, the level of assurance obtained by the assurance practitioner is likely to enhance the intended users' confidence about the financial statements.</p>	<p>ASRE 2400</p>
<p><b>Limited assurance engagement</b>—An assurance engagement in which the assurance practitioner reduces engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for expressing a conclusion in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the assurance practitioner's attention to cause the assurance practitioner to believe the compliance</p>	<p>ASAE 3100 ASAE 3150 ASAE 3500</p>

Terms	Source(s)
requirements have not been met, in all material respects. The nature, timing and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement but is planned to obtain a level of assurance that is, in the assurance practitioner's professional judgement, meaningful. To be meaningful, the level of assurance obtained by the assurance practitioner is likely to enhance the intended users' confidence about the compliance outcome to a degree that is clearly more than inconsequential. (see Assurance engagement)	
For subject matter specific definitions see: ASQC 1 or ASAE 3450.	
<b>Listed entity</b> means an entity whose shares, stock or debt are quoted or listed on a recognised stock exchange, or are marketed under the regulations of a recognised stock exchange or other equivalent body.	ASQC 1 ASA 220
<b>Long-form report</b> means assurance report including other information and explanations that are intended to meet the information needs of users but not to affect the assurance practitioner's conclusion. In addition to the matters required to be contained in the assurance practitioner's report long-form reports may describe in detail matters such as:	ASAE 3100 ASAE 3150
<ul style="list-style-type: none"> <li>(i). the terms of the engagement;</li> <li>(ii). the criteria being used, such as the specific control objectives and controls as designed to achieve each objective;</li> <li>(iii). descriptions of the tests of controls that were performed;</li> <li>(iv). findings relating to the the tests of controls that were performed or particular aspects of the engagement;</li> <li>(v). details of the qualifications and experience of the assurance practitioner and others involved with the engagement;</li> <li>(vi). disclosure of materiality levels; or</li> <li>(vii). recommendations.</li> </ul>	
The assurance practitioner may find it helpful to consider the significance of providing such information to meet the needs of the intended users. Additional information is clearly separated from the assurance practitioner's conclusion and worded in such a manner as make it clear that it is not intended to alter or detract from that conclusion.	
<b>Management</b> means the person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.	ASA 200 ASA 260
For subject matter specific definitions see: ASA 580, ASAE 3450 or ASAE 3610.	
<b>Management bias</b> means a lack of neutrality by management in the preparation of information.	ASA 540
<b>Management's expert</b> means an individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial report.	ASA 500 ASA 620
For subject matter specific definition see: ASAE 3610.	

Terms	Source(s)
<b>Management's point estimate</b> means the amount selected by management for recognition or disclosure in the financial report as an accounting estimate.	ASA 540
<b>Material</b> (in the context of a compliance engagement) means	ASAE 3100
(i) in relation to potential (for risk assessment purposes) or detected (for evaluation purposes) matter(s) of non-compliance – instance(s) of non-compliance that are significant, individually or collectively, in the context of the entity's compliance with compliance requirements, and that might influence relevant decisions of intended users or affect the assurance practitioner's conclusion; and/or	
(ii) in relation to the compliance framework and controls – instance(s) of deficiency that are significant in the context of the entity's control environment and that may raise the compliance engagement risk sufficiently to affect the assurance practitioner's conclusion.	
<b>Material control</b> means a control which is necessary to mitigate the risk of a control objective not being achieved and for which there are no or insufficient compensating controls. The relevant control objectives are those at the level to be concluded on in the assurance report, whether overall or specific control objectives.	ASAE 3150
<b>Material inconsistency</b> means information within the document that materially contradicts the financial information that is the subject of the assurance report.	ASAE 3450
<b>Materiality</b> (in the context of ASAE 3500) (see also <i>Performance materiality</i> ) means variations in performance of an activity evaluated against the identified criteria which, have the potential to affect the economy, efficiency and/or effectiveness of the activity and be reasonably expected to influence relevant decisions of the intended users or the discharge of accountability by the responsible party or governing body of the entity. (see also <i>Performance materiality</i> )	ASAE 3500
For subject matter specific definitions see: ASAE 3450 or ASAE 3610.	
<b>Measurer or evaluator</b> (in the context of ASAE 3000) means the party(ies) who measures or evaluates the underlying subject matter against the criteria. The measurer or evaluator possesses expertise in the underlying subject matter.	ASAE 3000 ASAE 3150
For subject matter specific definition see: ASAE 3100.	
<b>Misappropriation of assets</b> mean the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more capable of disguising or concealing misappropriations in ways that are difficult to detect.	ASA 240
<b>Misstatement</b> means a difference between the amount, classification, presentation, or disclosure of a reported financial report item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.	ASA 200 ASA 450
When the auditor expresses an opinion on whether the financial report is presented fairly, in all material respects, or gives a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgement, are necessary for	



Terms	Source(s)
the financial report to be presented fairly, in all material respects, or to give a true and fair view.	
For subject matter specific definitions see: ASAE 3000, ASAE 3100 or ASAE 3150.	
<b>Misstatement in the description of the system</b> means an inaccuracy, inadequacy or omission in the description, including in the identification of the boundaries and other identifying characteristics of the system, the control components described, the areas of activity encompassed and the controls as designed and/or implemented.	ASAE 3150
<b>Misstatement of fact</b> means information that is incorrectly stated or presented in the document. A material misstatement of fact may undermine the credibility of financial information that is the subject of the assurance report.	ASAE 3450
For subject matter specific definition see: ASAE 3000.	
<b>Misstatement of the other information</b> means a misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading (including because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information).	ASA 720
<b>Modified opinion</b> means a qualified opinion, an adverse opinion or a disclaimer of opinion on the financial report.	ASA 705
<b>Monitoring</b> means a process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is operating effectively.	ASQC 1 ASA 220
<b>Monitoring of controls</b> mean a process to assess the effectiveness of internal control performance over time. It includes assessing the design and operation of controls on a timely basis and taking necessary corrective actions modified for changes in conditions. Monitoring of controls is a component of internal control.	
<b>Multiple types of financial information</b> mean financial information that involves more than one type.	ASAE 3450
<b>Negative confirmation request</b> means a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.	ASA 505
<b>Network</b> means a larger structure:	ASQC 1 ASA 220
(a) That is aimed at cooperation, and	
(b) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.	
<b>Network firm</b> means a firm or entity that belongs to a network.	ASQC 1 ASA 220
<b>Non-compliance</b> means acts of omission or commission, intentional or unintentional, committed by the entity, or by those charged with governance, by management or by other individuals working for or under the direction of	ASA 250

Terms	Source(s)
the entity, which are contrary to the prevailing laws or regulations. Non-compliance does not include personal misconduct unrelated to the business activities of the entity. For subject matter specific definition see: ASAE 3100.	
<b>Non-IFRS financial information</b> means financial information that is presented other than in accordance with all relevant accounting standards.	ASAE 3450
<b>Non-public document</b> means a document in relation to a fundraising or a document containing prospective financial information, which is not a public document. It is not prepared in accordance with the Corporations Act 2001.	ASAE 3450
<b>Non-response</b> means a failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.	ASA 505
<b>Non-sampling risk</b> means the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.	ASA 530
<b>Objective of a performance engagement</b> is to evaluate the performance of an activity or activities, with respect to economy, efficiency and/or effectiveness against the identified criteria.	ASAE 3500
<b>Observation</b> means 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 control activities.	ASA 500
<b>Offering</b> means the making available of an entity's equity or debt securities to parties (who may be in overseas jurisdictions) ordinarily through: <ul style="list-style-type: none"> <li>(i). the sale of securities to the public under a prospectus;</li> <li>(ii). foreign offerings;</li> <li>(iii). an exempt transaction or offering (for example, a private placement of equity or debt securities to a limited number of investors, or an offering of debt securities issued or backed by public sector entities);</li> <li>(iv). certain securities transactions covered by specific laws or regulations (for example, exchange of shares in merger transactions); or</li> <li>(v). acquisition transactions in which there is an exchange of equity.</li> </ul>	ASRS 4450
<b>Opening balances</b> mean those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments. For subject matter specific definition see: ASAE 3610.	ASA 510
<b>Organisational boundary</b> means the boundary that determines which operations to include in the entity's GHG statement.	ASAE 3410
<b>Other financial information</b> means historical financial information and information other than historical financial information (for example prospective financial information)	ASQC 1

Terms	Source(s)
<b>Other information</b> means financial and non-financial information (other than the financial report and the auditor's report thereon) included in the entity's annual report.  For subject matter definition see: ASAE 3000.	ASA 720
<b>Other Matter paragraph</b> means a paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial report that, in the auditor's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.	ASA 706
<b>Outcome of an accounting estimate</b> means the actual monetary amount which results from the resolution of the underlying transaction(s), event(s) or condition(s) addressed by the accounting estimate.	ASA 540
<b>Overall control objectives</b> mean explicit or implicit assertions by the responsible party with respect to the subject matter, that in an assurance engagement on controls, represent the broad objectives or purpose of the controls, in the context of the control component and system included in the scope of the engagement.	ASAE 3150
<b>Partner</b> means any individual with authority to bind the firm with respect to the performance of an audit, review or other assurance engagement or related services engagement. "Partner" should be read as referring to a public sector equivalent where relevant.	ASQC 1 ASA 220
<b>Performance engagement</b> means an assurance engagement to conclude on the performance (expressed as either economy, efficiency and/or effectiveness) of all or a part of the activity or activities of an entity or across multiple entities as evaluated by identified criteria, commonly referred to as a performance audit.	ASAE 3500
<b>Performance materiality</b> means the amount or amounts set by the auditor at less than materiality for the financial report as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial report as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.  For subject matter specific definitions see: ASAE 3410 or ASAE 3610.	ASA 320
<b>Personnel</b> means partners and staff.	ASQC 1 ASA 220
<b>Pervasive</b>  For subject matter specific definition see: ASA 705 and ASAE 3150.	
<b>Population</b> means the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.  For subject matter specific definition see: ASAE 3150.	ASA 530
<b>Positive confirmation request</b> means a request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.	ASA 505
<b>Practitioner</b> means a professional accountant in public practice.	
<b>Preconditions for an audit</b> means the use by management of an acceptable financial reporting framework in the preparation of the financial report and	ASA 210

Terms	Source(s)
the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted.	
<b>Predecessor assurance practitioner</b> means the assurance practitioner from a different firm who conducted the assurance engagement on the general purpose water accounting report.	ASAE 3610
<b>Predecessor auditor</b> means the auditor from a different audit firm, who audited the financial report of an entity in the prior period and who has been replaced by the current auditor.	ASA 510
<b>Premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted</b> means that management and, where appropriate, those charged with governance have acknowledged and understand that they have the following responsibilities that are fundamental to the conduct of an audit in accordance with Australian Auditing Standards. That is, responsibility:	ASA 200
<ul style="list-style-type: none"> <li>(a) For the preparation of the financial report in accordance with the applicable financial reporting framework; including where relevant, their fair presentation;</li> <li>(b) For such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of a financial report that is free from material misstatement, whether due to fraud or error, and</li> <li>(c) To provide the auditor with: <ul style="list-style-type: none"> <li>(i). Access to all information, of which management and, where appropriate, those charged with governance are aware that is relevant to the preparation of the financial report such as records, documentation and other matters;</li> <li>(ii). Additional information that the auditor may request from management and, where appropriate, those charged with governance, for the purposes of the audit; and</li> <li>(iii). Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.</li> </ul> </li> </ul> <p>In the case of a fair presentation framework, (a) above may be restated as “for the preparation and fair presentation of the financial report in accordance with the financial reporting framework”, or “for the preparation of the financial report <i>that gives a true and fair view</i> in accordance with the financial reporting framework”.</p> <p>The “premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted” may also be referred to as the “premise.”</p>	
<b>Private placement</b> means securities offered for sale or issue in a prospectus to a limited number of investors, which are exempt, by law or regulation from certain content, distribution or registration requests in certain jurisdictions (“exempt offering”).	ASRS 4450
<b>Pro forma adjustments</b>	

Terms	Source(s)
For subject matter specific definitions see: ASAE 3420 or ASAE 3450.	
<b><i>Pro forma financial information</i></b>	
For subject matter specific definitions see: ASAE 3420, ASAE 3450 or ASRS 4450.	
<b><i>Procedures</i></b> mean procedures performed by the auditor which are specified by the requesting parties. The auditor does not determine whether the extent of such procedures is sufficient for the purposes of the requesting parties. Procedures may also be referred to as agreed-upon procedures.	ASRS 4450
<b><i>Procedures of an assurance nature</i></b> means procedures performed by an assurance practitioner which are the same or similar to procedures performed in an assurance engagement.	ASRS 4400
<b><i>Professional accountant</i></b> means an individual who is a member of an accounting professional body.	
<b><i>Professional accountant in public practice</i></b> means a professional accountant, irrespective of functional classification (for example, audit, tax or consulting) in a firm that provides professional services. This term is also used to refer to a firm of professional accountants in public practice.	
<b><i>Professional judgement</i></b> means the application of relevant training, knowledge and experience, within the context provided by assurance and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the engagement.	ASA 200 ASAE 3000 ASAE 3100 ASAE 3610 ASARE 2400
<b><i>Professional scepticism</i></b> means an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.	ASA 200
For subject matter specific definitions see: ASAE 3000, ASAE 3100, ASAE 3500 or ASAE 3610.	
<b><i>Professional standards</i></b> mean Australian Standards on Auditing (ASAs) and relevant ethical requirements.	
<b><i>Professional standards</i></b> (in the context of ASQC 1) means AUASB Engagement Standards, as defined in the AUASB's Preface to the Australian Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements, and relevant ethical requirements.	ASQC 1
<b><i>Prospective financial information</i></b> means of a predictive character prepared based on assumptions made by the responsible party, in accordance with the stated basis of preparation. Prospective financial information may be either:	<u>ASAE 3450</u>
(i) a forecast which is prepared based on the responsible party's assumptions as to future events expected to take place on the dates, or in the period, described and the actions expected to be taken at the date the financial information is prepared. It is commonly referred to as a —directors' forecast; or	
(ii) a projection which is prepared based on the responsible party's material hypothetical assumptions, or a mixture of assumptions and material hypothetical assumptions as to future events which are not necessarily expected to take place on the dates, or in the period, described and the actions not necessarily expected to be taken at the date the financial information is prepared (a —what-if scenario).	

Terms	Source(s)
<b>Prospectus</b> means a document issued pursuant to applicable law or regulation relating to the entity's securities on which it is intended that a third party should make an investment decision.	ASAE 3420
<b>Public document</b> For subject matter specific definitions see: ASAE 3420 or ASAE 3450.	
<b>Public sector</b> means national governments, regional (for example, state, provincial, territorial) governments, local (for example, city, town) governments and related governmental entities (for example, agencies, boards, commissions and enterprises).	
<b>Published financial information</b> means financial information of the entity or of an acquiree or a divestee that is made available publicly.	ASAE 3420
<b>Purchased offset</b> means an emissions deduction in which the entity pays for the lowering of another entity's emissions (emissions reductions) or the increasing of another entity's removals (removal enhancements), compared to a hypothetical baseline.	ASAE 3410
<b>Quantification</b> means the process of determining the quantity of GHGs that relate to the entity, either directly or indirectly, as emitted (or removed) by particular sources (or sinks).	ASAE 3410
<b>Reasonable assurance</b> means a high, but not absolute, level of assurance.	ASQC 1 ASAE 3000 ASAE 3100
For subject matter specific definition see: ASA 200.	
<b>Reasonable assurance engagement</b> <b>Reasonable assurance engagement</b> means an assurance engagement in which the assurance practitioner reduces engagement risk to an acceptably low level in the circumstances of the engagement as the basis the assurance practitioner's conclusion. The assurance practitioner's conclusion is expressed in a form that conveys the assurance practitioner's opinion on the outcome of the evaluation of the compliance activities against compliance requirements.(see Assurance engagement)	ASAE 3100 ASAE 3150
For subject matter specific definitions see: ASAE 3150 or ASAE 3450.	
<b>Reasonable grounds</b> means, in relation to a statement made, that there must be a sufficient objective foundation for that statement.	ASAE 3450
<b>Recalculation</b> means checking the mathematical accuracy of documents or records.	ASA 500
<b>Registered company auditor</b> includes an individual who meets the requirements of section 324BE of the Act.	ASRE 2415
<b>Related party</b> means a party that is either:	ASA 550
(i) A related party as defined in the applicable financial reporting framework; or	
(ii) Where the applicable financial reporting framework establishes minimal or no related party requirements:	
a. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;	
b. Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or	

Terms	Source(s)
<p>c Another entity that is under common control with the reporting entity through having:</p> <ul style="list-style-type: none"> <li>i Common controlling ownership;</li> <li>ii Owners who are close family members; or</li> <li>iii Common key management.</li> </ul> <p>However, entities that are under common control by a state (that is, a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another</p> <p><b>Related services</b> mean agreed-upon procedures and compilations.</p> <p><b>Relevant Date</b> means as applicable:</p> <ul style="list-style-type: none"> <li>(i). the allotment date;</li> <li>(ii). the effective date of the relevant proposed fundraising;</li> <li>(iii). the implementation date of the relevant proposed merger transaction; or</li> <li>(iv). in the case of a scheme of arrangement, the date of the shareholders or unit-holders meeting to vote on the scheme.</li> </ul> <p><b>Relevant ethical requirements</b> mean ethical requirements that apply to the auditor, assurance practitioner, engagement quality control reviewer and firm. In Australia, these include the applicable requirements of APES 110 Code of Ethics for Professional Accountants issued by the Accounting Professional and Ethical Standards Board, the applicable provisions of the Corporations Act 2001 and other applicable law or regulation.</p> <p><b>Removal</b> means the GHGs that the entity has, during the period, removed from the atmosphere, or that would have been emitted to the atmosphere had they not been captured and channelled to a sink.</p> <p><b>Reperformance</b> means the assurance practitioner's independent execution of procedures or controls that were originally performed by the responsible party.</p> <p><b>Report on the description and design of controls at a service organisation (referred to in ASA 402 as a type 1 report)</b> means a report that comprises:</p> <ul style="list-style-type: none"> <li>(a) A description, prepared by management of the service organisation, of the service organisation's system, control objectives and related controls that have been designed and implemented as at a specified date; and</li> <li>(b) A report by the service auditor with the objective of conveying reasonable assurance that includes the service auditor's opinion on the description of the service organisation's system, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives</li> </ul> <p><b>Report on the description and design of controls at a service organisation (referred to in this ASAE as a "type 1 report")</b> (in the context of ASAE 3402) means a report that comprises:</p> <ul style="list-style-type: none"> <li>(i). The service organisation's description of its system;</li> </ul>	<p>ASAE 3450</p> <p>ASA 102 ASA 220 ASQC 1 ASRE 2400</p> <p>ASAE 3410</p> <p>ASA 500 ASAE 3610</p> <p>ASA 402</p> <p>ASAE 3402</p>

Terms	Source(s)
<ul style="list-style-type: none"> <li>(ii). A written statement by the service organisation that, in all material respects, and based on suitable criteria: <ul style="list-style-type: none"> <li>a. The description fairly presents the service organisation's system as designed and implemented as at the specified date; and</li> <li>b. The controls related to the control objectives stated in the service organisation's description of its system were suitably designed as at the specified date; and</li> </ul> </li> <li>(iii). A service auditor's assurance report that conveys a reasonable assurance conclusion about the matters in (ii)a.-b. above.</li> </ul>	
<p><b><i>Report on the description, design, and operating effectiveness of controls at a service organisation (referred to in this Auditing Standard as a type 2 report)</i></b> means a report that comprises:</p> <ul style="list-style-type: none"> <li>(i). A description, prepared by management of the service organisation, of the service organisation's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and, in some cases, their operating effectiveness throughout a specified period; and</li> <li>(ii). A report by the service auditor with the objective of conveying reasonable assurance that includes: <ul style="list-style-type: none"> <li>a. The service auditor's opinion on the description of the service organisation's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and</li> <li>b. A description of the service auditor's tests of the controls and the results thereof.</li> </ul> </li> </ul>	ASA 402
<p><b><i>Report on the description, design and operating effectiveness of controls at a service organisation (referred to in this ASAE as a "type 2 report")</i></b> (in the context of ASAE 3402) means a report that comprises:</p> <ul style="list-style-type: none"> <li>(i). The service organisation's description of its system;</li> <li>(ii). A written statement by the service organisation that, in all material respects, and based on suitable criteria: <ul style="list-style-type: none"> <li>a. The description fairly presents the service organisation's system as designed and implemented throughout the specified period;</li> <li>b. The controls related to the control objectives stated in the service organisation's description of its system were suitably designed throughout the specified period; and</li> <li>c. The controls related to the control objectives stated in the service organisation's description of its system</li> </ul> </li> </ul>	ASAE 3402



Terms	Source(s)
<p>operated effectively throughout the specified period; and</p> <p>(iii). A service auditor's assurance report that:</p> <ol style="list-style-type: none"> <li>Conveys a reasonable assurance conclusion about the matters in (ii)a.-c. above; and</li> <li>Includes a description of the tests of controls and the results thereof.</li> </ol>	
<b>Reporting period</b> means the period for which a water accounting report is prepared.	ASAE 3610
<b>Representation</b> means statement by the responsible party, either oral or written, provided to the assurance practitioner to confirm certain matters or to support other evidence. A representation is additional to but may be provided in combination with the responsible party's or evaluator's Statement provided in an attestation engagement.	ASAE 3100 ASAE 3150
For subject matter specific definition see: ASAE 3500.	
<b>Representation letter</b> means a letter prepared by the entity at the request of the auditor that confirms to the auditor specific matters relating to the comfort letter engagement.	ASRE 4450
<b>Requesting parties</b> mean third party underwriter(s) and/or other parties involved with the entity's securities offering (such as financial intermediaries, buyers, sellers, brokers or selling agents or group or component auditors) that have agreed to be bound by the auditor's engagement letter (including by authorising the lead manager to sign on their behalf) in order to request the auditor's comfort letter, and may receive the comfort letter if they sign the auditor's engagement letter.	ASRS 4450
<b>Responsible party</b> means the party (ies) responsible for the underlying subject matter.	ASAE 3000
For subject matter specific definitions see: ASAE 3100, ASAE 3150, ASAE 3450, ASAE 3500 or ASAE 3610.	
<b>Responsible party of the entity</b> means those charged with governance of the entity (ordinarily the Board of Directors) who are responsible for the preparation of the offering document, and who engage the auditor to issue a comfort letter to the requesting parties and provide a copy to the responsible party.	ASRS 4450
<b>Review engagement</b> (see <i>Limited assurance engagement</i> )	ASRE 2400 ASRE 2405 ASRE 2410 ASAE 3000
<b>Review procedures</b> mean the procedures deemed necessary to meet the objective of a review engagement, primarily enquiries of entity personnel and analytical procedures applied to financial data.	ASRE 2410
<b>Revised Legislation</b> means Corporations Amendment (Corporate Reporting Reform) Act 2010.	ASRE 2415
<b>Risk assessment procedures</b> mean the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's	ASA 315

Terms	Source(s)
internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial report and assertion levels	
<b>Risk of material misstatement</b> means the risk that the financial report is materially misstated prior to audit. This consists of two components, described as follows at the assertion level:	ASA 200
<ul style="list-style-type: none"> <li>(a) Inherent risk means 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.</li> <li>(b) Control risk means the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.</li> </ul>	
For subject matter specific definition see: ASAE 3000.	
<b>Sampling</b> (see <i>Audit sampling</i> )	
For subject matter specific definition see: ASAE 3150.	
<b>Sampling risk</b> means the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:	ASA 530
<ul style="list-style-type: none"> <li>(i). In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.</li> <li>(ii). In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.</li> </ul>	
For subject matter specific definition see: ASAE 3150.	
<b>Sampling unit</b> means the individual items constituting a population.	ASA 530
<b>Scope of view</b> means the review procedures deemed necessary in the circumstances to achieve the objective of the review.	
<b>Service auditor</b>	ASA 402
For subject matter specific definitions see: ASA 402 or ASAE 3402.	
<b>Service organisation</b>	ASA 402
For subject matter specific definitions see: ASA 402, ASAE 3150 or ASAE 3402.	
<b>Service organisation's statement</b> means the written statement about the matters referred to:	ASAE 3402

Terms	Source(s)
<p>A written statement by the service organisation that, in all material respects, and based on suitable criteria:</p> <ol style="list-style-type: none"> <li>The description fairly presents the service organisation's system as designed and implemented throughout the specified period;</li> <li>The controls related to the control objectives stated in the service organisation's description of its system were suitably designed throughout the specified period; and</li> <li>The controls related to the control objectives stated in the service organisation's description of its system operated effectively throughout the specified period; or</li> </ol> <p>A written statement by the service organisation that, in all material respects, and based on suitable criteria:</p> <ol style="list-style-type: none"> <li>The description fairly presents the service organisation's system as designed and implemented as at the specified date; and</li> <li>The controls related to the control objectives stated in the service organisation's description of its system were suitably designed as at the specified date.</li> </ol>	
<p><b>Service organisation's system</b></p> <p>For subject matter specific definitions see: ASA 402 or ASAE 3402.</p>	ASA 402
<p><b>Short-form report</b></p> <p>For subject matter specific definitions see: ASAE 3100 or ASAE 3150.</p>	
<p><b>Significance</b> means the relative importance of a matter, taken in context. The significance of a matter is judged by the practitioner in the context in which it is being considered. This might include, for example, the reasonable prospect of its changing or influencing the decisions of intended users of the practitioner's report; or, as another example, where the context is a judgement about whether to report a matter to those charged with governance, whether the matter would be regarded as important by them in relation to their duties. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients.</p>	
<p><b>Significant component</b> means a component identified by the group engagement team (i) that is of individual financial significance to the group, or (ii) that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial report.</p>	ASA 600
<p><b>Significant deficiency in internal control</b> means a deficiency or combination of deficiencies in internal control that, in the auditor's professional judgement, is of sufficient importance to merit the attention of those charged with governance.</p>	ASA 265
<p><b>Significant facility</b> means a facility that is of individual significance due to the size of its emissions relative to the aggregate emissions included in the GHG statement or its specific nature or circumstances which give rise to particular risks of material misstatement.</p>	ASAE 3410
<p><b>Significant risk</b> means an identified and assessed risk of material misstatement that, in the auditor's judgement, requires special audit consideration.</p>	ASA 315

Terms	Source(s)
<b><i>Single financial statement or specific element of a financial statement</i></b> includes the related disclosure.	ASA 805
<b><i>Sink</i></b> means a physical unit or process that removes GHGs from the atmosphere.	ASAE 3410
<b><i>Smaller entity</i></b> means 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). 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.	
<b><i>Source</i></b> means a physical unit or process that releases GHGs into the atmosphere.	ASAE 3410
<b><i>Special purpose financial report</i></b> means a complete set of financial statements, including an assertion statement by those responsible for the financial report, prepared in accordance with a special purpose framework.	ASA 800
<b><i>Special purpose financial statements</i></b> mean financial statements prepared in accordance with a special purpose framework.	ASA 800 ASRE 2400
<b><i>Special purpose framework</i></b> means a financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework.(see Applicable financial reporting framework)	ASA 800 ASRE 2400
<b><i>Special purpose water accounting report</i></b> means a water accounting report tailored to the information needs of a user able to command this information.	ASEA 3610
<b><i>Specific control objective</i></b> means control objective expressed in sufficient detail such that controls can be designed to achieve that objective directly without further breakdown.	ASAE 3150
<b><i>Staff</i></b> means professionals, other than partners, including any experts the firm employs.	ASQC 1 ASA 220
<b><i>Standards on assurance engagements</i></b> mean standards made by the AUASB which establish requirements and provide explanatory guidance for undertaking and reporting on assurance engagements other than audits or	

Terms	Source(s)
reviews of historical financial information covered by Australian Auditing Standards or Standards on Review Engagements.	
<b>Standards on review engagements</b> mean standards made by the AUASB which establish requirements and provide explanatory guidance on the responsibilities of an auditor, or assurance practitioner, when engaged to undertake a review engagement and on the form and content of the auditor's, or assurance practitioner's, review report.	
<b>Stated basis of preparation</b> means the basis on which the responsible party has chosen to prepare the financial information that is acceptable in view of the nature and objective of the document, or as required by applicable law or regulation. A stated basis of preparation may include:	ASAE 3450
<ul style="list-style-type: none"> <li>(i). the recognition and measurement principles contained in the Australian Accounting Standards (but not all the presentation and disclosure requirements), and the entity's adopted accounting policies;</li> <li>(ii). recognition and measurement principles contained in the Australian Accounting Standards adjusted by pro forma adjustments, selected for the purpose for which the pro forma financial information (i.e. non-IFRS financial information) is presented;</li> <li>(iii). recognition and measurement principles other than those contained in Australian Accounting Standards; or</li> <li>(iv). a basis selected by the responsible party, in order to present the financial information for its intended purpose.</li> </ul>	
<b>Statement</b>	
For subject matter specific definitions see: ASAE 3100 or ASAE 3150.	
<b>Statistical sampling</b> means an approach to sampling that has the following characteristics:	ASA 530
<ul style="list-style-type: none"> <li>(i) Random selection of the sample items; and</li> <li>(ii) The use of probability theory to evaluate sample results, including measurement of sampling risk.</li> </ul> <p>A sampling approach that does not have characteristics (i) and (ii) is considered non-statistical sampling.</p>	
<b>Stratification</b> means the process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).	ASA 530
<b>Subject matter information</b>	
For subject matter specific definitions see: ASAE 3000, ASAE 3150 or ASAE 3610.	
<b>Subject matter or underlying subject matter</b>	
For subject matter specific definitions see: ASAE 3150 or ASAE 3500.	
<b>Subsequent events</b> mean events occurring between the date of the financial report and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.	ASA 560

Terms	Source(s)
For subject matter specific definition see: ASAE 3450	
<b>Subservice organisation</b>	
For subject matter specific definition see: ASA 402 ASAE 3402.	
<b>Substantive procedure</b> means an audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:	ASA 330
(a) Tests of details (of classes of transactions, account balances, and disclosures); and	
(b) Substantive analytical procedures.	
<b>Sufficiency</b> (of audit evidence) means the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.	ASA 200 ASA 500
<b>Suitable criteria</b> (See <i>Criteria</i> )	
<b>Suitably qualified external person</b> means an individual outside the firm with the competence and capabilities to act as an engagement partner. For example:	ASQC 1
<ul style="list-style-type: none"> <li>• a partner of another firm, or</li> <li>• a member (with appropriate experience) of a professional accountancy body whose members may perform audits and reviews of historical financial reports and other financial information, other assurance engagements or related services engagements, or</li> <li>• a member (with appropriate experience) of an organisation organization that provides relevant quality control services.</li> </ul>	
For subject matter specific definition see: ASA 220.	
<b>Summary financial statements</b> mean historical financial information that is derived from a financial report, or complete set of financial statements, but that contains less detail than the financial report, while still providing a structured representation consistent with that provided by the financial report, of the entity's economic resources or obligations at a point in time or the changes therein for a period of time. Different jurisdictions may use different terminology to describe such historical financial information.	ASA 810
<b>Supplementary information</b> means information that is presented together with the financial report that is not required by the applicable financial reporting framework used to prepare the financial report, normally presented in either supplementary schedules or as additional notes.	
<b>System</b> means the function or service at the entity, location or operational facility for which the controls are being reported upon by the assurance practitioner.	ASAE 3150
<b>Takeover</b> means the acquisition of control of listed or unlisted entities conducted in accordance with Chapter 6 of the Corporations Act 2001.	ASAE 3450
<b>Test</b> means the application of procedures to some or all items in a population.	

Terms	Source(s)
<b>Test of controls</b> mean an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.	ASA 330
For subject matter specific definitions see: ASAE 3150 or ASAE 3402.	
<b>Those charged with governance</b> means the person(s) or organisation(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.	ASA 200 ASA 260
For subject matter specific definition see: ASAE 3610.	
<b>Tolerable misstatement</b> means a monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.	ASA 530
<b>Tolerable rate of deviation</b>	
For subject matter definitions see: ASA 530 or ASAE 3150.	
<b>Type of emission</b> means a grouping of emissions based on, for example, source of emission, type of gas, region, or facility.	ASAE 3410
<b>Unadjusted financial information</b> means financial information of the entity to which pro forma adjustments are applied by the responsible party.	ASAE 3420
<b>Uncertainty</b> means a matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial report.	ASA 570
<b>Uncorrected misstatements</b> mean misstatements that the auditor has accumulated during the audit and that have not been corrected.	ASA 450
<b>Underlying subject matter</b> means the phenomenon that is measured or evaluated by applying criteria.	ASAE 3000
For subject matter specific definition see: ASAE 3610.	
<b>Underwriter</b> means any person or their agent who has purchased, or intends to purchase securities from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking. This ASRS also uses the term underwriter to refer to the managing or lead underwriter who ordinarily negotiates the underwriting agreement on behalf of a group of underwriters whose exact composition is not determined until shortly before an offering document becomes effective. The underwriters may or may not be named in the offering document, and are commonly the requesting parties.	ASRS 4450
<b>Underwriting agreement</b> means a formal agreement between the underwriter(s) and the responsible party of the entity with respect to the entity's offering document. It may specify the form and content of the comfort letter to be requested of the auditor, or that the form and content is to be specified by the requesting parties at a later time. The auditor is not a party to the underwriting agreement.	ASRS 4450

Terms	Source(s)
<b>Unmodified opinion</b> means the opinion expressed by the auditor when the auditor concludes that the financial report is prepared, in all material respects, in accordance with the applicable financial reporting framework.	ASA 700
<b>User auditor</b> For subject matter specific definition see: ASA 402 or ASAE 3402. For subject matter specific definitions see ASA 402, ASAE 3150 or ASAE 3402.	
<b>Variation</b> means an instance where the performance of the underlying subject matter exceeds the identified criteria or is deficient in whole or part, as evaluated against the identified criteria.	ASAE 3500
<b>Walk-through test</b> means tracing a selected number of transactions through the financial reporting system.	
<b>Water</b> means the liquid that descends from clouds as rain and forms streams, lakes, groundwater aquifers and seas. Water is a chemical compound comprising two atoms of hydrogen and one atom of oxygen. Water may exist in solid, liquid or gaseous form.	ASEA 3610
<b>Water accounting report</b> means may be either a general purpose water accounting report or a special purpose water accounting report.	ASAE 3610
<b>Water accounting statements</b> mean comprise the statement of water assets and water liabilities, the statement of changes in water assets and water liabilities, and the statement of water flows.	ASAE 3610
<b>Water asset</b> means water, or the rights or other claims to water, which the water report entity holds or transfers, and from which the water report entity, or stakeholders of the water report entity, derive future benefits.	ASAE 3610
<b>Water entity</b> means an entity that: (i). Holds or transfers water, or (ii). Holds or transfers rights or other direct or indirect claims to water, or (iii). Has inflows and/or outflows of water.	ASAE 3610
<b>Water liability</b> means a present obligation of the water report entity, the discharge of which is expected to result in a decrease in the water report entity's water assets or an increase in another water liability.	ASAE 3610
<b>Water report entity</b> means a water entity in respect of which it is reasonable to expect the existence of users who depend on general purpose water accounting reports for information about water, or rights or other claims to water, which will be useful to them for making and evaluating decisions about the allocation of resources.	ASAE 3610
<b>Written representation</b> means a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include the financial report, the assertions therein, or supporting books and records.	ASA 580

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# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**        **7.1.1**

**Meeting Date:**            12 September 2018

**Subject:**                 AUASB Technical Work Program Update

**Date Prepared:**          5 September 2018

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☒ **Action Required**

☐ **For Information Purposes Only**

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## Agenda Item Objectives

1. To provide the AUASB with a final version of the 2017-18 Technical Work Program and an update on the AUASB's Strategic Priority projects.

## Background

2. The AUASB Technical Group prepared a Draft 2017-18 Technical Work Program and presented it to the AUASB for consideration in September 2017. This Technical Work Program was then subject to feedback from constituents at the AUASB/UNSW Audit Roundtable in October 2017 and a series of AUASB Consultation Forums held in November 2017, before being finalised in November 2017.
3. The AUASB Technical Group has produced a status update of the AUASB Technical Work Program for the AUASB to review quarterly since it was finalised. The format of this update aligns to the reporting we are required to present to the FRC to ensure consistency and reduce duplication. This is provided to the board at the first meeting following the end of each quarter.
4. Additional to the Technical Work Program, Project Plans for each of our nominated Strategic Projects have been prepared and presented to the AUASB for review and feedback at each subsequent meeting where required.

## Matters to Consider

5. The Final 2017/18 AUASB Technical Work Program is provided to board members for review at Agenda Item 7.1.1.

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*This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.*

6. This Final 2017/18 AUASB Technical Work Program has been reviewed by the AUASB Chair and has been used as the basis for information that populates our AUASB Performance Report in the Combined AASB-AUASB 2017-18 Annual Report.
7. The document was also provided to AUASB via email from the AUASB Chair on 27 August 2018 to determine if any AUASB members had any concerns with the content of this report, in particular the assessment of the overall status for each current priority and KPI (the traffic lights). No changes were suggested to the overall status of individual Priorities/KPIs, however feedback was received that, in future versions and updates for the board in the following year:
  - (a) There needs to be greater granularity reflecting not only the status of each priority/KPI but also whether it is on schedule; and
  - (b) That the 2018-19 Technical Work program should also describe in greater detail how the Work Program achieves the AUASB Strategy and how the Work Program connects with/complement the AASB equivalent document.

#### **AUASB Technical Group Recommendations**

8. Provide feedback to the AUASB Technical Group on the Final 2017/18 AUASB Technical Work Program presented at Agenda Item 7.1.2.
9. Provide suggestions to the AUASB Technical Group about additions and changes AUASB members would like included in the 2018/19 AUASB Technical Work Program document.

#### **Material Presented**

Agenda Item 7.1.1	AUASB Board Meeting Summary Paper
Agenda Item 7.1.2	Final 2017/18 AUASB Technical Work Program

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High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
1) Issue Australian Auditing and Assurance Standards	→ Issue all IAASB related Australian equivalent Exposure Drafts on a timely basis (within 3 months of PIOB clearance or within 1 month of AUASB approval, as appropriate).	N/A	<ul style="list-style-type: none"> <li>Current major IAASB projects monitored and analysed at each AUASB meeting and as part of AUASB Chair and/or Technical Director attending IAASB Meetings in accordance with the AUASB International Strategy (refer below), however no new IAASB standards issued in current period.</li> <li>Project plans for IAASB standard on Auditing Estimates (ISA 540) developed and shared with AUASB.</li> <li>ASA 540 and ISA 315 EDs released shortly after end of financial year for response in late 2018.</li> </ul>
	→ Develop and issue Australian Auditing and Assurance Standards (for 2017-18, ASA 540 Auditing Accounting Estimates and Related Disclosures) following the release of their equivalent ISA, ensuring all Australian legislative and regulatory requirements are considered, including changes required via application of the 'compelling reason' test.	N/A	
	→ Develop high quality responses to other IAASB pronouncements or invitations to comment by the due date as they are released.	N/A	
	→ Coordinate and develop the AUASB's response to existing and planned IAASB exposure drafts due for release (for 2017-18, ISA 540, ISA 315, ISQC 1, ISA 220 & ISA 600).	●	<ul style="list-style-type: none"> <li>AUASB response to ISA 540 ED developed via roundtables and feedback from Australian stakeholders then submitted to the IAASB in August 2017.</li> <li>Other IAASB EDs planned for release in current year were delayed, so will be issued in 2018-19 year.</li> </ul>
	→ Conduct post-implementation reviews of IAASB equivalent issued AUASB Standards, where deemed necessary.	N/A	<ul style="list-style-type: none"> <li>No ISA's or Global equivalent ASA's subject to a post-implementation review in the current period.</li> </ul>
	→ Review AUASB Process for exposing and issuing IAASB EDs	●	<ul style="list-style-type: none"> <li>AUASB process to expose IAASB standards reviewed at April 2018 meeting. New process to release AUASB ED's in conjunction with the IAASB's timetable being piloted for ISA 315 in second half of 2018.</li> </ul>



High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	→ Develop an AUASB International Strategy	●	<ul style="list-style-type: none"> <li>AUASB International Strategy developed, ensuring our input on IAASB and other international activities is appropriately targeted and effective. The strategy formalises how the AUASB Board and Staff engage with the IAASB and other global standard setting bodies, including other National Standards Setters</li> </ul>
2) Develop, update and maintain Australian specific Standards and/or Guidance Statements	→ Develop and issue Australian specific Standards (for 2017-18, ASAE 3500 Performance Engagements) within 1 month of AUASB approval, in accordance with AUASB legislative drafting and registration requirements.	●	<ul style="list-style-type: none"> <li>Revised ASAE 3500 <i>Performance Engagements</i> released in October 2017.</li> </ul>
	→ Review and revise out of date Guidance Statements (for 2017-18, GS 010 & GS 019, others to be reviewed 2018-2020).	●	<ul style="list-style-type: none"> <li>Plans to review a number of current Australian specific Standards and/or Guidance Statements (ASAE 3450, GS 010 and GS 019) not implemented in the current period due to other priorities and a direction from the AUASB to delay a revision of GS 010 (Questions at AGMs) until another year of KAMs has been observed.</li> </ul>
	→ Review full suite of AUASB pronouncements to determine necessity and timing of other required updates.	●	<ul style="list-style-type: none"> <li>Not completed in current period. Individual pronouncements updated where required but a full review of the AUASB framework is still to be performed.</li> </ul>

High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	→ Conduct post-implementation reviews of Australian specific AUASB Standards, where deemed necessary.	N/A	<ul style="list-style-type: none"> <li>No standards scheduled for a post implementation in the current period.</li> <li>Initial post implementation activities associated with the introduction of the enhanced Auditor Reporting requirements underway, with AUASB staff liaising with IAASB staff to align activities and collaboration with academics to identify relevant research under consideration.</li> </ul>
	→ Update of ASA 102 to ensure updated Code of Ethics is reflected in ASA's	●	<ul style="list-style-type: none"> <li>Revised ASA 102 to ensure updated Code of Ethics is reflected in ASA's approved at March 2018 AUASB meeting.</li> </ul>
	→ Review and update of AUASB Glossary	●	<ul style="list-style-type: none"> <li>Plan to update AUASB Glossary approved by AUASB in April, with updates currently under way at year end.</li> </ul>
3) Monitor the Assurance Environment	→ Conduct yearly AUASB Agenda Consultation Forums in various locations, either face to face or electronically, (for 2017-18 in late 2017) and update AUASB Workplan as required based on relevant feedback.	●	<ul style="list-style-type: none"> <li>November 2017 AUASB Agenda Consultation Forums held in Sydney, Melbourne, Adelaide, Perth and Brisbane, with a wide array of stakeholders participating in roundtable discussions that inform the AUASB's current and future technical work program.</li> </ul>
	→ Hold quarterly meetings with CPA Australia, and CA ANZ professional accounting bodies to discuss trends in assurance environment and identify impact for AUASB Agenda and Workplan.	●	<ul style="list-style-type: none"> <li>Regular meetings held with technical representatives of the professional bodies and ASIC, however generally on specific issues, as opposed to regular formal catch ups.</li> </ul>

High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	→ Ensure AUASB attendance and presentations at a number of research events (in 2017-18, including AFAANZ Conference and co-ordinating with the AFAANZ Auditing and Assurance Special Interest Group, and holding the AUASB / UNSW Audit Research Roundtable in Oct 2017).	●	<ul style="list-style-type: none"> <li>Combined AUASB / UNSW Audit Roundtable held in October 2017</li> <li>AUASB Chair and staff members attended the 2017 ANCAAR and 2018 AFAANZ Conferences</li> <li>AUASB Chair presented at AAA Conference in the US and EAA Conference in Europe on Audit Quality matters.</li> </ul>
	→ Develop and implement AUASB Research Strategy (for 2017-18, develop by March 2018).	●	<ul style="list-style-type: none"> <li>Draft AUASB Research Strategy considered at the April 2018 AUASB meeting, however additional work required. To be completed in 2018-19 period.</li> </ul>
	→ Assess and respond to implementation issues (for 2017-18, those identified in the June 2017 ASIC Inspection Report) in connection with the strategic project on 'Coordination and cooperation with Regulators'.	●	<ul style="list-style-type: none"> <li>Ongoing dialog and outputs being developed in relation to ASIC Inspection implementation issues in conjunction with ASIC staff and Large Audit firms as part of Audit Quality strategic projects and FRC Audit Quality Plan.</li> </ul>
	→ Develop and implement FRC Audit Quality Plan	●	<ul style="list-style-type: none"> <li>AUASB Chair and staff assisted the FRC Chair develop the FRC Audit Quality Plan.</li> <li>All AUASB responsibilities under the Plan progressing well, including the Audit Committee Chairs survey on perceptions of audit quality.</li> </ul>
	→ Develop updated guidance to encourage the increased application and understanding of review engagements	●	<ul style="list-style-type: none"> <li>Additional guidance to assist practitioners understand and implement Review engagements in accordance with the ASRE standards still to be developed.</li> </ul>

High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	→ Consider audit quality and implementation issues associated with the audit of superannuation funds (incl. SMSF's, GS 009) and other assurance issues in the financial services area	●	<ul style="list-style-type: none"> <li>Meetings held with ASIC and APRA to discuss audit quality and implementation issues associated with the audit of superannuation funds, before the matter was presented to the AUASB and FRC members. Concluded no further action required by the AUASB – oversight of Super Fund audits to be in scope for ASIC (RSEs) and the ATO (SMSFs).</li> </ul>
4) Build, maintain and enhance key international relationships	→ AUASB to be represented at all IAASB meetings.	●	<ul style="list-style-type: none"> <li>AUASB Chair and/or Technical Director have attended all IAASB meetings in 2017-18, and developed good relationships with key IAASB members, technical advisors and staff.</li> <li>Feedback on IAASB agenda and reporting back on outcomes from meetings implemented in accordance with the AUASB International Strategy.</li> </ul>
	→ Arrange for AUASB review of relevant IAASB board papers on a timely basis and share feedback on key matters with regional IAASB members before each IAASB meeting.	●	<ul style="list-style-type: none"> <li>All major IAASB projects monitored and analysed at each AUASB meeting and as part of AUASB Chair and/or Technical Director attending IAASB Meetings in accordance with the AUASB International Strategy.</li> </ul>
	→ Attend and present relevant topics at regional and global IAASB NSS meetings	●	<ul style="list-style-type: none"> <li>Assisted IAASB by presenting two sessions at the global NSS meeting in May 2018. Now working with IAASB to revitalise the NSS network as a key global stakeholder group and developing agenda for additional NSS to be held in conjunction with World Congress of Accountants in Sydney in November 2018.</li> </ul>



High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	→ Increase our awareness of and influence with IFAC SMP Committee activity given the high level of SMP/SME exposure in Australia and NZ	●	<ul style="list-style-type: none"> <li>Yet to establish relationship with Australian based IFAC SMP member to progress this issue as intended.</li> </ul>
	→ Attend and contribute to other IAASB or International Standard Setting forums as appropriate	●	<ul style="list-style-type: none"> <li>Currently organising a regional National Standards Setters meeting aligned to the World Congress of Accountants in Nov 18.</li> <li>Response to Monitoring Group Consultation sent in February 2018. Co-hosted Australian Consultation forums to discuss Monitoring Group responses and developments in December 2017 and June 2018, as well as AUASB Chair attending Global consultation forum in Singapore in January 2018.</li> </ul>
	→ Review and contribute as appropriate to other global initiatives, such as IIRC and GRI, on assurance issues.	●	<ul style="list-style-type: none"> <li>AUASB Chair has contributed to global assurance forums as member of the United Nations World Business Council for Sustainable Development assurance task force and member of the International Integrated Reporting Committee (IIRC) working group.</li> </ul>
	→ Engage with the Global EER Project Advisory Panel and support associated regional activities and local panel members.	●	<ul style="list-style-type: none"> <li>AUASB member Jo Cain appointed to IAASB EER Project Advisory Panel in February 2018, with AUASB staff providing technical input.</li> </ul>





High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
5) Maintain harmonisation of auditing and assurance standards in Australia and New Zealand	→ AUASB Chair and/or Technical Director to attend all NZAuASB meetings.	●	<ul style="list-style-type: none"> <li>AUASB Chair and/or Technical Director has attended all NZAuASB meetings either in person or via teleconference.</li> </ul>
	→ Ensure standards and guidance (in 2017-18, ASA 540) are issued in accordance with AU/NZ harmonisation requirements.	N/A	<ul style="list-style-type: none"> <li>Not applicable as no common AUASB/NZAuASB standards issued in the current period.</li> </ul>
	→ Work collaboratively with NZAuASB Technical Staff to ensure co-operation and co-ordination between the AUASB and NZAuASB's activities (e.g. joint research programs and joint contributions on key focus areas, such as Assurance requirements for NFP's and Charities).	●	<ul style="list-style-type: none"> <li>AUASB and NZAuASB Chairs and Technical Directors consistently in contact to explore opportunities to collaborate on International and Regional initiatives, as well as ensure a common approach to local and international auditing and assurance issues in accordance with the AUASB/XRB protocol.</li> <li>In order to improve this even further, a more integrated and regular mechanism to identify further opportunities to be explored in the 2018-19 year.</li> </ul>

High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	→ Contribute to and work in parallel on a number of NZAuASB projects, specifically Auditor Reporting FAQs, the NZ FMA Report on Auditor Reporting and the Audit of Service Performance Information standard.	●	<ul style="list-style-type: none"> <li>AUASB staff member seconded to work with the NZAuASB on a project evaluating the rollout of new Auditor Reporting requirements in New Zealand with report co-produced with the NZ FMA released in November 2018.</li> <li>AUASB Technical Staff made a submission on the NZ <i>Audit of Service Performance Information ED</i> in December 2017 and provided additional input to NZAuASB staff on the topic over the whole period.</li> </ul>
6) Complete a number of strategic projects addressing current areas of auditing and assurance thought leadership and emerging issues	→ Scope and implement strategic thought leadership projects in the following areas:	/	<ul style="list-style-type: none"> <li>AUASB staff have completed and presented project plans on all strategic projects outlined in the AUASB 2017-21 Corporate Plan at 2017-18 AUASB meetings.</li> <li>Where relevant, updates on each strategic project are provided to members at all AUASB meetings.</li> </ul>
	○ Auditor Reporting Implementation	●	<ul style="list-style-type: none"> <li>All aspects associated with this strategic project have been addressed by AUASB staff, with implementation issues monitored via with AUASB members and audit firms to identify further opportunities.</li> </ul>










High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	<ul style="list-style-type: none"> <li>○ Audit Quality / Coordination and cooperation with Regulators</li> </ul>	●	<ul style="list-style-type: none"> <li>• All AUASB responsibilities under the Plan progressing well, including the Audit Committee Chairs survey on perceptions of audit quality.</li> <li>• Ongoing dialog and outputs being developed in relation to ASIC Inspection implementation issues in conjunction with ASIC staff and Large Audit firms.</li> </ul>
	<ul style="list-style-type: none"> <li>○ Assurance over Emerging Forms of External Reporting (EER)</li> </ul>	●	<ul style="list-style-type: none"> <li>• Various initiatives to support Assurance over EER information current being developed.</li> <li>• AUASB actively involved in Global EER Assurance approach being led by IAASB and supported by the WBCSD.</li> <li>• Project to develop accounting and auditing guidance encouraging improved recognition and disclosures relating to the impact of climate change in progress at year end (NB: joint project with AASB, ASIC and FRC)</li> <li>• AUASB Chair has contributed to global assurance forums as member of the United Nations World Business Council for Sustainable Development assurance task force and member of the International Integrated Reporting Committee (IIRC) working group</li> </ul>

High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	<ul style="list-style-type: none"> <li>○ Prescribed Reports</li> </ul>	●	<ul style="list-style-type: none"> <li>• AUASB staff have identified various instances where incorrect terms or statements inconsistent with the Assurance Framework are being applied and taken measures to amend these.</li> <li>• Worked with various Government agencies to ensure guidance issued when implementing any audit or assurance regulations are</li> </ul>
	<ul style="list-style-type: none"> <li>○ Financial Reporting and Assurance Frameworks</li> </ul>	●	<ul style="list-style-type: none"> <li>• An AUASB Technical staff member has assisted the AASB complete the assurance elements of their research reports and consultation papers on Financial Reporting Requirements for Charities/NFPs, For Profit and Public Sector agencies.</li> <li>• AUASB Technical Staff are assisting the AASB on their projects to review the conceptual framework, fair value measurement in the public sector and disclosures.</li> </ul>
	<ul style="list-style-type: none"> <li>○ Public Sector Auditing and Assurance Issues</li> </ul>	●	<ul style="list-style-type: none"> <li>• Plans for Public Sector audit issues approved at the March AUASB meeting.</li> <li>• Ongoing dialog with Auditor-Generals offices and preliminary work to set up Project Advisory Group on the topic under way at year end.</li> </ul>
	<ul style="list-style-type: none"> <li>○ Consideration of matters related to small and medium practices (SMPs) and audits of small- and medium-sized entities (SMEs)</li> </ul>	●	<ul style="list-style-type: none"> <li>• Paper updating AUASB members on different SMP/SME options presented and discussed at April AUASB meeting.</li> <li>• Project on hold at year end – awaiting IAASB developments.</li> </ul>

High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	<ul style="list-style-type: none"> <li>○ Data Analytics/Digitisation of the Audit</li> </ul>	●	<ul style="list-style-type: none"> <li>• First phase of project mapping Data Analytics and Technology issues to current auditing standards complete.</li> </ul>
	<ul style="list-style-type: none"> <li>○ Superannuation Audit Issues</li> </ul>	●	<ul style="list-style-type: none"> <li>• Meetings held with ASIC and APRA to discuss audit quality and implementation issues associated with the audit of superannuation funds, before the matter was presented to the AUASB and FRC members. Concluded no further action required by the AUASB – oversight of Super Fund audits to be in scope for ASIC (RSEs) and the ATO (SMSFs).</li> </ul>
	→ With the AASB, update the ‘Alignment of Reporting and Auditing Frameworks’ review completed by the University of Adelaide and CA ANZ to ensure it reflects current audit and assurance requirements, and consult with appropriate policy makers and regulators.	●	<ul style="list-style-type: none"> <li>• AUASB has worked with FRC Chair to progress this project and ensure the scope aligns to the Assurance Framework and outputs will support the work the AUASB technical team does in respect of its ‘Prescribed Reports’ strategic project.</li> <li>• AUASB a party to letter of support to back the academics working on this project.</li> </ul>
	→ Develop and maintain contact with other key national standard setters (e.g. Canada, France, Germany, Netherlands, United Kingdom, United States and South Africa) and identify opportunities to collaborate on key international auditing and assurance focus areas.	●	<ul style="list-style-type: none"> <li>• AUASB Chair and Technical Director have established valuable connections with other NSS representatives through the IAASB NSS Forum and via attendance at IAASB meetings.</li> <li>• Meeting in May with NZAuASB and Canadian Auditing Board representatives to take forward strategic-three-country NSS initiative</li> <li>• Planning initiated to have a National Standard setters meeting held around the World Congress of Accountants.</li> </ul>



High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	→ Monitor key international regulator developments (including IOSCO, PCAOB and IFIAR) and consider impact for the local auditing and assurance environment.	●	<ul style="list-style-type: none"> <li>Through the IAASB and NSS networks the AUASB technical group has considered and responded to a wide range of international auditing and assurance issues and consider the local impact on stakeholders (eg. Monitoring Group response).</li> </ul>
	→ Work with relevant local and international stakeholders to influence and support emerging forms of assurance (e.g. IIRC).	●	<ul style="list-style-type: none"> <li>AUASB Chair contributes to various global assurance forums (eg. UN WBCSD, IIRC) and ongoing support provided to Australian representatives on the IAASB Global EER project advisory panel.</li> <li>AUASB member Jo Cain appointed to IAASB EER Project Advisory Panel in February 2018, with AUASB staff providing technical input and assistance.</li> <li>AUASB Chair as a member of FRC releasing a position statement on external reporting</li> </ul>
7) Achieve a high level of stakeholder satisfaction through increased engagement	→ Hold quarterly meetings with key stakeholders (CPA, CA ANZ, APESB, ASIC) and ensure regular contact with other stakeholders (ACAG, ACNC, CER, APRA, AICD & IPA) as required to: <ul style="list-style-type: none"> <li>gather timely and relevant feedback on AUASB activities; and</li> <li>ensure the AUASB Workplan is responsive to user needs.</li> </ul>	●	<ul style="list-style-type: none"> <li>Regular meetings held with the professional bodies and ASIC, including consistent interaction with these stakeholders on the MG response and FRC Audit Quality Plan.</li> <li>For future periods a more consistent, formal approach to arranging and responding to these meeting needs to be established.</li> </ul>

High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	→ Attend and present at regular professional and regulatory forums (e.g. ASIC Standing Committee, Emerging Accounting and Auditing, Issues Discussion Group, BLRF etc.).		<ul style="list-style-type: none"> <li>AUASB attends and presents at all ASIC Accounting and Auditing Standing Committee meetings</li> <li>AUASB Technical Director presented at APESB NOCLAR sessions in Sept 17 and Jun 18</li> <li>AUASB staff attend and present at a range of other regular industry forums.</li> </ul>
	→ AUASB Board members or staff to present at a number of auditing or assurance related events/conferences		<ul style="list-style-type: none"> <li>AUASB Chair presented on Audit Quality and Data Analytics at conferences in US, Europe and AFAANZ conference over the period.</li> <li>AUASB member presented AUASB update at CA ANZ Audit Conference.</li> </ul>
	→ Complete quarterly reports for the FRC and obtain positive feedback from FRC members on AUASB activities.		<ul style="list-style-type: none"> <li>All quarterly and annual FRC reporting requirements met, with very positive feedback received from the FRC on AUASB activities.</li> </ul>
	→ Develop and distribute a quarterly AUASB Update		<ul style="list-style-type: none"> <li>Revised AUASB Update Newsletter developed and then issued quarterly (in Oct 17, Feb 18 &amp; May 18)</li> </ul>
	→ Conduct AUASB Stakeholder satisfaction survey in 2nd half of FY18.		<ul style="list-style-type: none"> <li>Still to be performed by AASB-AUASB National Director (in conjunction with the AASB).</li> </ul>
	→ Create and maintain details of AUASB stakeholders in the new AASB/AUASB Stakeholder Database.		<ul style="list-style-type: none"> <li>Updated AUASB stakeholder engagement database with comprehensive list of AUASB contacts populated by AUASB staff, however new stakeholder management tool yet to be implemented</li> </ul>
	→ Contribute to planning the new AASB/AUASB website.		<ul style="list-style-type: none"> <li>Redevelopment of AUASB website deferred as part of revised AASB-AUASB IT strategy.</li> </ul>

High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	→ Implement initiatives to monitor and grow stakeholder engagement, measured via increased media mentions, social media activity and level of participation at AUASB events.	●	<ul style="list-style-type: none"> <li>Work with AUASB Communications Manager to increase social media publications on Twitter, LinkedIn associated with recent AUASB events and publications has led to increased 'hits' and distribution, but further work required to assess effectiveness of existing communications activities.</li> </ul>
	→ Make all AUASB meeting board papers available on the AUASB website a week in advance and highlights/podcast available within 2 working days after each meeting.	●	<ul style="list-style-type: none"> <li>All required AUASB Board Meeting papers, highlights, podcasts and minutes have been available on the AUASB website in a timely manner</li> </ul>



High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
8) Conduct awareness initiatives and promote the development of education initiatives by others	→ Record and release AUASB podcasts and/or webcasts on all major audit and assurance pronouncements (e.g. ASA 540, Auditor Reporting).	●	<ul style="list-style-type: none"> <li>Podcast with highlights released following all 2017/18 AUASB meetings, covering all new AUASB pronouncements</li> </ul>
	→ Engage with the CA ANZ and CPA Australia to support the currency and appropriateness of auditing and assurance professional program course materials.	●	<ul style="list-style-type: none"> <li>AUASB Chair and Technical Director involved in initial discussions with CPA Australia around new courses on assurance of non-financial subject matter and performance engagements</li> <li>Discussions held by AUASB Chair with CA ANZ re the impact of their revised strategy on their education program</li> </ul>
	→ AUASB Board members or staff to present at a number of auditing or assurance related events/conferences (e.g. CA ANZ Audit Conference).	●	<ul style="list-style-type: none"> <li>AUASB Chair participated in a KPMG/Australian Financial Review Trust Roundtable in February 2018</li> <li>AUASB board members have presented at CA ANZ Audit Conference and Business leaders Reporting Forum</li> <li>AUASB Technical Director presented at APESB NOCLAR sessions in Sept 17 and Jun 18</li> <li>AUASB Chair and Technical Director presented to ACAG staff on Public Sector Audit Issues in March 18</li> <li>AUASB member presented AUASB update at CA ANZ Audit Conference.</li> </ul>
	→ Author or contribute to multiple articles on major auditing and assurance developments for CPA Australia and CA ANZ professional bulletins.	●	<ul style="list-style-type: none"> <li>CA ANZ Perspectives article on 'Other Information' published in April 2018.</li> </ul>

High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
	→ Identify opportunities to present guest lectures or be represented on course advisory panels for auditing and assurance topics at major tertiary institutions.	●	<ul style="list-style-type: none"> <li>AUASB-UNSW Roundtable promoting education initiatives and research attended by over 50 auditing/assurance experts from the profession, regulators and academia held in October 2017</li> <li>Presentation to RMIT Accounting Academics by AUASB Technical Director in June 2018</li> <li>AUASB Chair member of Deakin University School of Accounting Advisory Panel</li> <li>Presented at University of Melbourne, and held discussions with University of Melbourne staff</li> </ul>
	→ Partner with respected auditing and assurance academics on AUASB strategic projects and research activities, for example on Auditor Reporting implementation.	●	<ul style="list-style-type: none"> <li>Dialog with academics on auditor reporting established and AUASB staff have contributed to the thinking of a number of related academic initiatives.</li> <li>An area to receive greater focus in the following period as part of the AUASB Research Strategy.</li> </ul>
	→ In conjunction with the NZAuASB, issue new and revised Auditor Reporting FAQs based on stakeholder feedback and issues noted by AUASB staff.	●	<ul style="list-style-type: none"> <li>Auditor Reporting FAQs on AUASB website being updated regularly</li> </ul>
	→ Develop and issue AUASB Bulletins to provide guidance to Stakeholders as required on AUASB Pronouncements and topical/emerging auditing and assurance issues and in conjunction with the release of all major AUASB standards and guidance statements.	●	<ul style="list-style-type: none"> <li>AUASB Bulletins released on 'The new enhanced Auditor's Report – responding to questions at AGMs' in October 2017 and Auditor review reports – the impact of the new auditor reporting requirements' in July 2017.</li> </ul>

High level priorities	Current Priorities & KPIs	Overall Status	Comments / Update
9) Analyse regulator inspection findings to identify AUASB actions that help improve audit quality and the consistency of audit execution	→ Increased and timelier engagement with ASIC and other regulators responsible for audit and assurance inspections.	●	<ul style="list-style-type: none"> <li>The AUASB Chair and AUASB Technical staff have assisted the FRC develop their Audit Quality Plan. Survey to Audit Committee Chairs on their perceptions of audit quality now completed with analysis of results currently in progress.</li> <li>Review of ASIC Inspection Report findings performed as part of the 'Working Effectively with Regulators' strategic project.</li> <li>The AUASB Chair and Technical Group staff have held and are regularly holding meetings with ASIC Executive Director to discuss ASIC Inspection issues and plan for future AUASB involvement in audit inspection activities.</li> <li>Meetings held with technical staff from large accounting forms to evaluate points of intersection and opportunities to improve auditing standards and guidance.</li> <li>Results from Global regulator inspection activities considered as part of the AUASB's work with ASIC on local inspection activities.</li> </ul>
	→ Assess and respond to implementation issues (for 2017-18, those identified in the June 2017 ASIC Inspection Report) and identify opportunities to create additional AUASB guidance to address findings.	●	
	→ Hold quarterly meetings with ASIC and meet at least annually with other regulators (APRA, CER) to discuss audit inspection developments and identify opportunities for AUASB staff involvement.	●	
	→ Monitor global audit inspection developments and trends and consider impact for Australian auditing and assurance environment.	●	

**Key:**

●	Not done/ completed
●	Partially completed/in progress
●	Completed
N/A	Not applicable for 2017-18 financial year



# AUASB Board Meeting Summary Paper

## AGENDA ITEM NO. 7.2.1

**Meeting Date:** 12 September 2018  
**Subject:** AUASB Draft Forward Agenda  
**Date Prepared:** 27 August 2018

The below table sets out the expected timing of when the AUASB's projects and other matters will be discussed at AUASB meetings for all planned dates until the end of 2019. As projects progress and circumstances change, further amendments to the below table will be required. Items highlighted are expected to require a larger allocation of agenda time and/or relate to critical decisions for the AUASB.

		2019					To be allocated
Meeting month	Dec	Mar	Apr	Jun	Sep	Dec	
# of days	2	1	2	1	1	2	
AUASB Pronouncements							
AUASB Glossary	✓						
ASA 540	✓**						
GS 019 <i>Fundraising</i>	✓		✓				
GS 016 <i>Bank Confirmations</i>	✓		✓				
GS 010 <i>Questions at AGMs</i>							✓
GS 012 <i>Prudential Reporting</i>	✓						
ASAE 3450							✓
Guidance on review engagements							✓
International Projects							
ISA 315	✓	✓		✓#	✓**		
ISQC 1	✓#	✓*		✓	✓	✓	
ISA 600	✓	✓		✓	✓	✓#	
Audit Evidence		✓		✓	✓		
ISQC 2		✓#	✓*		✓	✓	
ISA 220		✓#	✓*		✓	✓	
AUP	✓	✓	✓#				
Emerging forms of External Reporting	✓	✓					
IAASB Strategy	✓^			✓	✓^		
IESBA Coordination (new code)					✓	✓	
SME/SMPs	✓	✓^					
Data Analytics	✓						
Professional Scepticism	✓	✓		✓	✓	✓	
Auditor Reporting PIR	✓	✓		✓	✓	✓	
Monitoring Group	✓	✓		✓	✓	✓	
NSS Collaboration	✓	✓		✓	✓	✓	
Report on IAASB Meetings	✓	✓	✓		✓	✓	
AUASB Strategic Projects							
Audit Quality	✓	✓	✓	✓	✓	✓	
Use of Technology in the audit	✓	✓	✓	✓	✓	✓	
Auditor Reporting Implementation	✓	✓	✓	✓	✓	✓	
Frameworks							✓
Forward agenda continued on next page							

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	2018		2019				To be allocated
Meeting month	Dec	Mar	Apr	Jun	Sep	Dec	
# of days	2	1	2	1	1	2	
<b>AUASB Strategic Projects (continued)</b>							
SMEs/SMPs	✓	✓	✓	✓	✓		
EER	✓	✓	✓	✓	✓	✓	
Public Sector	✓	✓	✓	✓	✓	✓	
Managed Investment Schemes							✓
<b>Other AUASB Priorities</b>							
Research Strategy	✓						
NZ Standard on SPI	✓						
Climate Change Disclosures	✓						
Safe harbour provisions							
AASB Chair Update			✓				
AUASB Technical work plan update	✓		✓		✓	✓	
Guest Presentations			✓			✓	
Joint AUASB/AASB session							✓
Joint AUASB/NZAuASB session							✓
<b>Corporate Reporting</b>							
FRC Reporting	✓		✓		✓	✓	
AASB-AUASB Annual Report	✓				✓	✓	
AASB-AUASB Corporate Plan					✓		

#### Notes:

\* Anticipated finalisation of Australian Exposure Draft

\*\* Anticipated finalisation of Australian Pronouncement

# Consideration of IAASB fatal flaw (standard or exposure draft)

^ Consideration of IAASB Consultation Paper

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## APPENDIX 1 – SUPPORTING INFORMATION

### IAASB Forward Agenda International Standard key dates

Standard	Meeting	Outcome
ISA 315	Jun 2019	Anticipated finalisation of Standard
ISQC 1	Sep 2018	Anticipated finalisation of Exposure Draft
	Mar 2020	Anticipated finalisation of Standard
ISQC 2	Dec 2018	Anticipated finalisation of Exposure Draft
	Mar 2020	Anticipated finalisation of Standard
ISA 220	Dec 2018	Anticipated finalisation of Exposure Draft
	Mar 2020	Anticipated finalisation of Standard
SMP	Mar 2019	Anticipated finalisation of Consultation Document
AUP	Mar 2019	Anticipated finalisation of Exposure Draft
	Jun 2020	Anticipated finalisation of Standard
ISA 600	Dec 2020	Anticipated finalisation of Exposure Draft

### AUASB/IAASB Meeting timing

AUASB Meeting	IAASB Meeting
12 Sep 18	17 Sep 18
4-5 Dec 18	10 Dec 18
6 Mar 19	11 Mar 19
16-17 Apr 19	
12 Jun 19	17 Jun 19
11 Sep 19	16 Sep 19
3-4 Dec 19	9 Dec 19

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# AUASB Board Meeting Summary Paper

## AGENDA ITEM NO. 7.3.1

**Meeting Date:** 12 September 2018  
**Subject:** Response by AUASB Technical Group to Safe Harbour Issue  
**Date Prepared:** 30 August 2018  
**Prepared by:** Tim Austin

☒ Action Required

☐ For Information Purposes Only

### Agenda Item Objectives

1. The objective of this agenda item is to:
  - (a) **Discuss** with the AUASB, possible directions for a publication;
  - (b) **Outline** options that have been considered by the AUASB Technical Group (ATG); and
  - (c) **Seek responses** to questions 1-3 included in this Board Meeting Summary Paper.

### Background

2. As part of *Other Business* at the April 2018 AUASB Meeting, an AUASB Member brought to the attention of the AUASB the recently effective 'safe harbour' provisions of the *Corporations Act 2001*. The ATG was requested to consider whether there are any assurance implications for the AUASB as a result of this legislative change and report back to the AUASB.
3. In considering the assurance implications the ATG:
  - (a) reviewed the legislative changes to the relevant sections of the *Corporations Act 2001*;
  - (b) reviewed materials published regarding the changes; and
  - (c) conducted limited outreach with specific practitioners.

An overview of the legislative changes have been prepared and included as Appendix A to this paper.
4. The view of the ATG is that, although the legislation was drafted with restructuring and turnaround experts in mind (and with their input), there are some aspects of the 'safe harbour' legislation in which an assurance engagement could add value.

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5. Alongside the assessment of the assurance implications of ‘safe harbour’, the ATG also considered possible assurance implications of other current events such as remediation requirements of the Banking Royal Commission and voluntary disclosures recommended by the Task Force on Climate-related Financial Disclosures (TCFD).
6. The view of the ATG is that other assurance or related-services engagements may add value for stakeholders in meeting the requirements of ‘safe harbour’ legislation, remediation requirements of the Banking Royal Commission or TCFD disclosures, and that the suite of standards available could be communicated to stakeholders through a publication(s) by the AUASB.

#### Questions

1. Does the AUASB see merit in creating a document(s) to be used by stakeholders to understand the possible value-add of other assurance and related-services engagements in different scenarios?

#### What is the issue and can it be addressed through standard-setting activities?

7. The first step undertaken by the ATG in determining whether a publication is needed was considering: is there an issue; is there a public-interest benefit in addressing it; can it best be addressed through standard-setting activities; and does it align with the AUASB Strategy.
  - **Issue** – Possible assurance or related-service activities emerging from events such as the introduction of ‘safe harbour’ legislation and the Banking Royal Commission. Stakeholders may lack knowledge of the other assurance or related-services engagements available under the suite of AUASB standards which could add value to them.
  - **Public-interest** – Would stakeholders benefit from other assurance or related-services engagements? Boards, regulators and other stakeholders can benefit from the enhanced credibility achieved through these engagements. For example, ‘safe harbour’ legislation is not prescriptive as to what directors need to do to be able to rely on ‘safe harbour’. Rather, directors are expected to undertake activities to put themselves in a position to make an informed decision about whether the business can be turned around.
  - **Standard-setting activity** – Under section 227B(1)(c) of the *Australian Securities and Investments Commission Act 2001*, the AUASB may formulate guidance on auditing and assurance matters. The exact form and location of publication to be discussed below.
  - **AUASB Strategy** – Objective 7 – Develop guidance and education initiatives, or promote development by others, to enhance consistent application of auditing and assurance standards and guidance.

#### Questions

2. Does the AUASB agree with the ATG’s assessment of the issue and that it is best addressed through standard-setting activities?



## **What is the form of a possible publication?**

8. After outlining the issue that needs to be addressed, the next step was to consider the form of a possible publication. The issue does not relate to a gap in the suite of AUASB standard and accordingly does not require an amendment of an existing standard or the issuance of a new standard. Based on this assessment an informal (FAQs, Bulletins) or Framework (Framework, Guidance Statement) publication may be the best response.
9. As other possible assurance or related-services activities have arisen, the ATG has considered whether a principles-based approach, which can be used across activities, or a targeted approach for each activity is appropriate.
10. Each option has been outlined and discussed below in paragraphs 11-18.

### ***A principles-based approach***

#### *Overview*

11. To respond to the potential assurance or related-services activities, including ‘safe harbour’, in a timely and effective manner, the ATG proposes a principles-based approach supported by examples based on ‘safe harbour’ and other activities.
12. A principles-based approach could outline the other assurance and related-services options available under the framework of standards. The purpose being to draw attention to the potential value add of these engagements for stakeholders and to demonstrate that these engagements can be applied over a wide-range of subject matters, offering differing levels of assurance.
13. The ATG proposes that a table/decision tree drawn from the *Categorisation of Underlying Subject Matters* table in Appendix 4 of the *AUASB Framework for Assurance Engagements* be prepared. Additional columns could be added to the table/decision tree to assist stakeholders – such as relevant standards and the levels of assurance under those standards. A table has been prepared for illustrative purposes and included as Agenda Paper 7.3.2.
14. To enhance the usefulness of the table/decision tree, “real-life examples” could be included. These examples would be based on emerging issues where other assurance and related-service engagement could add value for stakeholders. For example, a practitioner could be engaged to undertake a compliance engagement to ensure that appropriate records are kept to meet ‘safe harbour’ requirements.
15. As the need arises additional examples can be added to the document such as the remediation activities as a result of the Banking Royal Commission.

#### *How would it work?*

16. As outlined above, this possible publication could be done as either an informal publication or a framework pronouncement. The recommendation of the ATG is as an addendum to the *AUASB Framework for Assurance Engagement*.
17. Additional detailed materials in the form of FAQ’S could be published and refer to the addendum if more specific guidance is needed by stakeholders for certain topics.

### ***Targeted Document***

#### *Overview*

18. Rather than a principles-based approach, an FAQ could be published for each topic and outline the potential value add of other assurance and related-services engagements. The ATG is of the view

that preparing an FAQ every time a new assurance issue arises would be ineffective in meeting the needs of stakeholders in a timely manner and would inefficient.

### **AUASB Technical Group Recommendations**

19. The ATG recommends that a principles-based publication focusing on the value add available to stakeholders through other assurance and related-services engagements be further explored by the AUASB. The benefits of a principles-based approach are:
- (a) Timeliness – a principles-based publication which only requires examples to be updated means that the AUASB is responsive to stakeholder needs as new situations arise;
  - (b) Usefulness – a principles-based publication is useful to stakeholders in understanding the other assurance and related-services engagements available to them, the value these engagements can add and in which circumstances they can be applied; and
  - (c) Use of AUASB time – a principles-based publication which only requires examples to be updated means that the ATG and the AUASB are not undertaking complete re-writes of publications each time a new issue comes to the attention of the AUASB.

### **Questions**

3. Does the AUASB agree with the ATG's recommendation that a principles-based publication should be further considered by the AUASB?

### **Material Presented**

Agenda Item 7.3.1	AUASB Board Meeting Summary Paper
Agenda Item 7.3.2	AUASB Framework for Assurance Engagements Extract

### **Action Required**

No.	Action Item	Deliverable	Responsibility	Due Date	Status
1.	Consider whether to further explore a publication	Respond to questions 1 and 2	AUASB	12 September 2018	In-progress

## ATTACHMENT A

20. In September 2017, the *Treasury Laws Amendments (2017 Enterprise Incentives No.2) Act 2017* was assented by the Parliament of Australia. The Act introduced two key changes to the *Corporations Act 2001*:
- (a) 'Safe harbour' provisions which protect directors, in certain situations, from personal civil liability for insolvent trading; and
  - (b) A stay on enforcing 'ipso facto' termination rights which allows a contract to be terminated solely due to the fact that an insolvency event has occurred.

### *Safe harbour provisions*

21. The 'safe harbour' provisions, inserted as s588GA, provide directors with relief from s588G(2) of the *Corporations Act 2001* in which a director can be personally liable for debts incurred by a company trading whilst there are reasonable grounds to suspect the company was either insolvent or would become insolvent.
22. The relief will only apply in certain circumstances and is subject to directors meeting a number of compliance requirements including tax reporting and employee entitlements. A director under s588GA will not be civilly liable for insolvent trading if they start developing one or more courses of action that are reasonably likely to lead to a better outcome for the company and that the debts being incurred are incurred directly or indirectly in connection with any such course of action.
23. In determining whether a course of action is reasonably likely to lead to a better outcome, regard may be had to whether the director:
- (a) is properly informing himself or herself of the company's financial position; or
  - (b) is taking appropriate steps to prevent any misconduct by officers or employees of the company that could adversely affect the company's ability to pay all its debts; or
  - (c) is taking appropriate steps to ensure that the company is keeping appropriate financial records consistent with the size and nature of the company; or
  - (d) is obtaining advice from an appropriately qualified entity who was given sufficient information to give appropriate advice; or
  - (e) is developing or implementing a plan for restructuring the company to improve its financial position.
24. The 'safe harbour' legislation also introduces provisions limiting the enforcement of 'ipso facto' clauses, this effectively stays the enforcement of provisions of a contract that allow a contract to be terminated solely due to the fact that an insolvency event has occurred.



# Attachment to AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**           **7.3.2**

**Meeting Date:**               12 September 2018

**Subject:**                     Response by AUASB Technical Group to Safe Harbour Issue

**Date Prepared:**             4 September 2018

**Prepared by:**               Tim Austin

## Matters to Consider

1. The below table is an excerpt of the *Categorisation of Underlying Subject Matters* which is contained in Appendix 4 of the AUASB *Framework for Assurance Engagements*.
2. The table has been prepared for illustrative purposes only to support the principles-based approach recommendation of the AUASB Technical Group (ATG) in paper 7.3.1. Financial information has been excluded in this example as the focus is on other assurance and related-services engagements.
3. The relevant standard and level of assurance columns have not been populated. These will begin to be populated if the AUASB sees merit in preparing a publication of this nature.
4. No action items arise for the AUASB from this agenda item.

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Information about:		Historical Information	Future Orientated Information	Relevant standard(s)	Level of assurance available
<b>Non-Financial</b>	Performance/ Use of Resources/ Value for Money	<ul style="list-style-type: none"> <li>Greenhouse Gas Statement</li> <li>Sustainability Report</li> <li>KPIs</li> <li>Statement on effective use of resources</li> <li>Statement on Value for Money</li> <li>Corporate social responsibility reporting</li> </ul>	<ul style="list-style-type: none"> <li>Expected emissions reductions attributable to a new technology, or Greenhouse Gases to be captured by planting trees</li> <li>Statement that a proposed action will provide value for money</li> </ul>	<i>To be populated</i>	<i>To be populated</i>
	Condition	<ul style="list-style-type: none"> <li>Description of a system/process as implemented at a point in time</li> <li>Physical characteristics, for example, the size of leased property</li> </ul>		<i>To be populated</i>	<i>To be populated</i>
<b>System/Process</b>	Description	<ul style="list-style-type: none"> <li>The description of a system of internal control</li> </ul>		<i>To be populated</i>	<i>To be populated</i>
	Design	<ul style="list-style-type: none"> <li>The design of controls at a service organisation</li> </ul>	<ul style="list-style-type: none"> <li>The design of proposed controls for a forthcoming production process</li> </ul>	<i>To be populated</i>	<i>To be populated</i>
	Operation/ Performance	<ul style="list-style-type: none"> <li>The operating effectiveness of procedures for hiring and training staff</li> </ul>		<i>To be populated</i>	<i>To be populated</i>
<b>Aspects of Behaviour</b>	Compliance	<ul style="list-style-type: none"> <li>An entity's compliance with e.g., loan covenants, or specific legal or regulatory requirements</li> </ul>		<i>To be populated</i>	<i>To be populated</i>
	Human Behaviour	<ul style="list-style-type: none"> <li>Evaluation of audit committee effectiveness</li> </ul>		<i>To be populated</i>	<i>To be populated</i>
	Other	<ul style="list-style-type: none"> <li>The fitness for purpose of a software package</li> </ul>		<i>To be populated</i>	<i>To be populated</i>

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# AUASB Board Meeting Summary Paper

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**AGENDA ITEM NO.**        **7.5.1**  
**Meeting Date:**            12 September 2018  
**Subject:**                  Climate-Related Disclosures Update  
**Date Prepared:**          28 August 2018

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☐ **Action Required**

☒ **For Information Purposes Only**

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## Agenda Item Objectives

1. To update the AUASB on the joint Climate related disclosures project being undertaken with the AASB.

## Background

AUASB are currently working collaboratively with the AASB on a communication piece to be released in October/November 2018.

The main objectives of this project are to identify:

- (a) what Australian publicly listed entities should consider including in their financial statements and annual report in relation to climate-related disclosures, e.g. impairment of assets and asset retirement obligations; and
- (b) assurance considerations that the auditor needs to be aware of in respect of climate-related disclosures.

The AUASB has agreed with AASB that a short media release and news alert will be produced based on research done to date focusing on the financial statements and existing requirements to disclose climate change as a material environmental risk. This publication will target directors and auditors specifically on what they need to consider when disclosing and auditing climate related disclosures.

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**Matters to Consider**

***Part A – General***

1. Refer to the AASB Climate-related disclosures project update at Agenda Item 7.5.2.

***Part B – NZAuASB***

1. N/A

***Part C – “Compelling Reasons” Assessment***

1. N/A

The proposed changes conform with IAASB modification guidelines for NSS? N/A

**Material Presented**

Agenda Item 7.5.1	AUASB Board Meeting Summary Paper
Agenda Item 7.5.2	AASB Climate-Related Disclosures Project Update



## Staff paper

<b>Project:</b>	<b>Climate-Related Disclosures</b>	<b>Meeting:</b>	AASB September 2018 (M167)
<b>Topic:</b>	<b>Project update</b>	<b>Agenda Item:</b>	10.1
<b>Contact(s):</b>	Shachini Dassanayake <a href="mailto:sdassanayake@asb.gov.au">sdassanayake@asb.gov.au</a> 03 9617 7633  Marina Michaelides <a href="mailto:mmichaelides@auasb.gov.au">mmichaelides@auasb.gov.au</a> 03 8080 7438	<b>Project Priority:</b>	Medium
		<b>Decision-Making:</b>	Medium
		<b>Project Status:</b>	Planning

### Objective of this paper

- 1 The objective is to obtain the Board's views on the staff recommendations on the climate-related disclosures project.

### Project outcome

- 2 A joint publication be issued by the AASB and the Auditing and Assurance Standard Board (AUASB) as per the Staff recommendation stated in paragraph 10 below.

### Background

- 3 Existing and potential investors, regulators and other primary users of financial statement are becoming increasingly interested in climate-related disclosures. This is also evident by the following changes and initiatives in climate-risk and broader sustainability reporting space:
  - (a) Recent [media release](#) by Investor Group on Climate Change;
  - (b) A [briefing paper](#) on the Global Investor Statement on Governments in Climate Change was issued early this year by seven investor organisation including The Investor Group on Climate Change (IGCC, Australia/New Zealand), Principles for Responsible Investors (PRI) and UN Environmental Program Finance Initiative (UNEP FI);
  - (c) Increased number of voluntary guidance/framework being issued by international bodies such as Task Force on Climate Related Financial Disclosures;
  - (d) Australian Prudential Regulation Authority is conducting a climate-risk survey of about 50 of the institutions it supervises;
  - (e) Australian Securities and Investments Commissioner John Price reinforced the importance of clear climate risk disclosures in his recent [public speech](#); and
  - (f) ASX Corporate Governance Council's Consultation Paper *Review of the ASX Corporate Governance Council's Principles and Recommendations* proposed changes to recommendation 7.4 of its Corporate Governance principles which highlighted climate change as one particular source of environmental risks.
- 4 It has been observed that entities do not disclose climate-risk related information either because it is not quantitatively material or they have concluded that the entity is not affected by climate change.



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### Staff analysis

- 5 Staff are of the view that there is a lack of understanding on how the materiality concept should be used to identify whether climate-risk related information should be disclosed.
- 6 As per [AASB Practice Statement 2 Making Materiality Judgements](#), information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity.
- 7 Making materiality judgements involves both quantitative and qualitative considerations. Staff are of the view that it would not be appropriate for the entity to rely on purely numerical guidelines. Qualitative factors are characteristics of an entity's transactions, other events or conditions, or of their context that, if present, make information more likely to influence the decisions of the primary users of the entity's financial statements.
- 8 As emphasised in AASB Practice Statement 2, an item of information could reasonably be expected to influence primary users' decisions regardless of its size – a quantitative threshold could even reduce to zero. Example K in the AASB Practice Statement 2 explains how a bank should assess information about the lack of exposure to a debt originating from a country, whose national economy is currently experiencing severe financial difficulties (since the bank is holding a very small amount of debt or even no debt at all originating from that country, while other international banks operating in the same sector have significant holdings) as material and disclose that information in its financial statements.
- 9 Furthermore, materiality judgements may lead to the disclosure of information in addition to the specific disclosure requirements in Australian Accounting Standards. (For example how climate-related risks are factored in to assumptions used to determine the recoverable amount of their non-financial assets).

### Staff recommendation

- 10 Based on the above analysis, staff consider that the AASB and the AUASB should issue a joint publication, outlining that entities in the energy, industrial and mining sectors and any other entities that are likely to be significantly impacted by climate change should consider the specific guidance in AASB Practice Statement 2 in determining whether climate-risk related information is material and whether disclosures related to climate risk should be made in its financial statements.
- 11 It would also be helpful to highlight in the publication that entities in sectors that are highly impacted by climate related risks but have assessed as not exposed to such risks, are expected to disclose that fact as it still could be a material information to investors.

#### Question for Board members

Do the Board members agree with the above Staff recommendations in paragraph 10 and 11?

AUASB

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# AUASB August Update

August 2018

## Introduction

The AUASB newsletter is a snapshot of developments at the AUASB and in international assurance standard setting.

## Latest news

### Issued for comment: Exposure Drafts ASA 315 and ASA 540

Following an additional AUASB meeting in July where these EDs were reviewed and approved, we are now inviting comments on EDs of revisions to:

- > ASA 315 *Identifying and Assessing Risks of Material Misstatement*
- > ASA 540 *Auditing Accounting Estimates and Related Disclosures*.

*Further information and to register for the roundtables.*

### AUASB-NZAuASB Webinar: ISA 315 Exposure Draft – recording and presentation available

Jointly hosted with the NZAuASB, this 90-minute webinar features IAASB Member and Chair of the ISA 315 Task Force Fiona Campbell, who explains the key revisions to the auditor's risk assessment procedures, as introduced through the recently published ISA 315 ED.

*Listen to the recording.*

*Download the slides.*

### AUASB Auditor Reporting FAQ update

The AUASB [Auditor Reporting FAQ](#) has been updated to include Question B14 which addresses the question of whether Key Audit Matters are likely to, or should, change each year.

### FRC releases its Position Statement on External Reporting

In response to the increasing demand from investors and other stakeholders for disclosures of non-financial information, the Financial Reporting Council (FRC) has released its [Position Statement on External Reporting](#).

*Read more.*

## Upcoming events

### AUASB Roundtables: Have your say on Exposure Drafts ASA 315 and ASA 540

Have your say on EDs ASA 315 and ASA 540. During September/October the AUASB technical team will be talking with stakeholders around Australia. We want to hear your views on these recently released EDs, in particular ASA 315 where your feedback will help inform

our response to the IAASB.

*[Register now.](#)*

### **IAASB global discussion on EER**

The IAASB is holding a series of discussions globally, with the Australian discussion to be held in Sydney on Friday 2 November to help shape the future of assurance over emerging forms of external reporting (EER).

*[Further information and registration.](#)*

### **AUASB September 2018 meeting**

The next AUASB board meeting will be held in Sydney on Wednesday 12 September.

## **International update**

### **IAASB: June 2018 Meeting update**

A summary of outcomes from this meeting includes updates on ISA 540, ISA 315 and ISQC 1 is available [here](#).

### **UK FRC: New report on audit culture**

The UK FRC has issued a new report *[Audit Culture Thematic Review](#)* which states its intention to encourage audit firms to create a culture where achieving high-quality audit is valued and rewarded, and emphasises the importance of 'doing the right thing' in the public interest.

### **CPA Canada: Audit guides released**

> *[Audit Committee Guide to Audit Quality Indicators](#)* – this step-by-step guide aims to help audit committees and management identify relevant AQIs, and understand how they can be used to spark discussions about improving audit quality.

> *[Audit considerations related to cryptocurrency assets and transactions](#)* – learn about considerations related to auditing an entity with material cryptocurrency assets and transactions under the Canadian Auditing Standards.

### **IFAC: Publications updated**

> *[Guide to Practice Management for Small- and Medium-Sized Practices](#)* – this guide aims to help SMPs operate more efficiently in the increasingly complex and competitive global marketplace for professional services.

> *[Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities](#)* – this guide aims to help practitioners apply the ISAs on SME audits. Updates reflect changes to the ISAs since previous editions, including IAASB projects on auditor reporting, disclosures, auditor responsibilities relating to other information and using the work of internal auditors.

## **In case you missed it**

### **AUASB June 2018 Meeting Highlights**

Highlights from the June AUASB Board Meeting are available to [read](#) or [listen to](#).

### **IAASB set to approve ED ISRS 4400**

The IAASB has expedited their timetable on the revision of ISRS 4400 *Engagement's to Perform Agreed-Upon Procedures Regarding Financial Information*. It is likely that an ED of revised ISRS 4400 will be taken to the September 2018 IAASB in New York for approval to issue. The AUASB will monitor the progress of this ED and will input into the international standard setting process as appropriate.

A full discussion of ISRS 4400 will occur at the 12 September 2018 AUASB meeting. A revised ISRS 4400 will in time impact the Australian equivalent ASRS 4400 *Agreed-Upon Procedures Engagements to Report Factual Findings*.

**Treasury seeking feedback on changing audit requirement of SMSFs**

The Treasury is seeking feedback on a measure announced in the 2018-19 Budget to change the annual audit requirement to a three yearly requirement from 1 July 2019 for self-managed superannuation funds (SMSFs) with a history of good record-keeping and compliance.

AUASB stakeholders with an interest in SMSFs are encouraged to review and comment on the proposal.

The AUASB Technical Group has had preliminary discussions with the professional bodies and Treasury about this issue, particularly with a view to considering if any changes may be necessary to Guidance Statement 009 *Auditing Self-Managed Superannuation Funds* as a result of this potential change. [Read more.](#)

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