



## AUASB Agenda Paper

<b>Project:</b>	FRC and Audit Quality	<b>Meeting:</b>	8-9 June 2021
<b>Topic:</b>	FRC and Audit Quality	<b>Agenda Item:</b>	2.0
<b>Strategic Objectives:</b>	4	<b>Decision-Making:</b>	For information purposes
<b>ATG Staff:</b>	Anne Waters	<b>Project Status:</b>	Ongoing

### A. Action Required and Decisions to be Made

- 1 The purpose of this agenda item is to provide an update on FRC and Audit Quality matters.

### B. AUASB Technical Group (ATG) Recommendations Overview and Questions for the Board

Question for the Board	ATG Recommendations Overview
N/A	N/A

### C. Matters for Board Consideration

- 2 FRC update – Chair to provide verbal report
- 3 Audit quality
  - (a) PJC Inquiry into Regulation of Auditing in Australia

At the time of finalising this paper the Australian government are yet to respond to the PJC's final report. Representatives from the FRC, ASIC, AASB, AUASB, APESB and AICD have been working together planning on how to implement the recommendations. Refer to attached working paper *PJC Regulation of Auditing in Australia - Status of recommendations* for further information.

- (b) Stakeholder's views on Audit Quality – verbal update

### D. Attachments to the Agenda Paper

Agenda Item	Description
2.1	PJC Regulation of Auditing in Australia - Status of recommendations

PJC Regulation of Auditing in Australia - Status of recommendations

	Recommendation	Status
1.	<p>The committee recommends that ASIC:</p> <ul style="list-style-type: none"> <li>- formally review the manner in which it publicly reports the periodic findings of its audit inspection program, giving appropriate consideration to approaches used internationally; and</li> <li>- based on this review, develop and implement, by the end of the 2020–21 reporting period for its audit inspection program, a revised framework for reporting inspection findings, with a focus on the transparency and relative severity of identified audit deficiencies.</li> </ul>	<ul style="list-style-type: none"> <li>- In progress as this was already being considered by ASIC.</li> <li>- While ASIC already publishes significant information on severity of findings, ASIC is actively considering the possibility of an additional measure of findings.</li> </ul>
2.	<p>The committee recommends that the Australian Government introduce, by the end of the 2020–21 financial year, through appropriate legislation, a requirement that ASIC publish all future individual audit firm inspection reports on its website once ASIC has adopted a revised reporting framework referred to in Recommendation 1.</p>	<ul style="list-style-type: none"> <li>- ASIC obtained consent from the largest six firms to publish the individual audit inspection reports for the 12 months to 30 June 2020. Each firm published the previous two reports.</li> </ul>
3.	<p>The committee recommends that the Financial Reporting Council, in partnership with ASIC, by the end of the 2020–21 financial year, oversee consultation, development and introduction under Australian standards of:</p> <ul style="list-style-type: none"> <li>- defined categories and associated fee disclosure requirements in relation to audit and non-audit services; and</li> <li>- a list of non-audit services that audit firms are explicitly prohibited from providing to an audited entity.</li> </ul>	<p>In progress.</p> <ul style="list-style-type: none"> <li>- The APESB and AASB are working together on the defined categories and fee disclosure requirements.</li> <li>- The International Ethics Standards Board has recently released revisions to the code in relation to prohibited non-audit services. The APESB have approved an exposure draft which will be issued in the coming weeks in Australia.</li> </ul>
4.	<p>The committee recommends that the <i>Corporations Act 2001</i> be amended so that an auditor's independence declaration is expanded to require the auditor to specifically confirm that no prohibited non-audit services have been provided.</p>	<p>This will require an amendment to the <i>Corporations Act 2001</i>.</p>
5.	<p>The committee recommends that the Australian Professional and Ethical Standards Board consider revising the APES 110 Code of Ethics to include a safeguard that no audit partner can be incentivised, through remuneration advancement or any other means or practice, for selling non-audit services to an audited entity.</p>	<ul style="list-style-type: none"> <li>- Already exists at individual partner level ie. cannot be incentivised for selling non-audit services to that partner's audit clients, however there is no prohibition currently in the Code for selling non-audit services to other audits clients of the firm.</li> </ul>

## PJC Regulation of Auditing in Australia - Status of recommendations

	Recommendation	Status
		<ul style="list-style-type: none"> <li>- APESB have approved an exposure draft which will be issued shortly in Australia, which includes a safeguard that a key audit partner cannot be compensated for selling non-assurance services to any audit client of the firm, to respond to this recommendation.</li> </ul>
6.	<p>The committee recommends that the Financial Reporting Council, by the end of the 2020–21 financial year, oversee the revision and implementation of Australian standards to require audited entities to disclose auditor tenure in annual financial reports. Such disclosure should include both the length of tenure of the entity's external auditor, and of the lead audit partner.</p>	<p>In progress. ASIC, the AASB, AUASB and AICD have been discussing:</p> <ul style="list-style-type: none"> <li>- which entities should be required to disclose this, and</li> <li>- where this disclosure should be reside ie. directors' report, financial statements or auditor's report.</li> </ul> <p>The preference is in the directors' report however the financial statements is also a valid option. Further work is progressing on these questions and how to legislate. The AICD is also undertaking further work on how to give effect to this in the absence of a legislative requirement.</p>
7.	<p>The committee recommends that the <i>Corporations Act 2001</i> be amended to implement a mandatory tendering regime such that entities required to have their financial reports audited under the Act must:</p> <ul style="list-style-type: none"> <li>- undertake a public tender process every ten years; or</li> <li>- if an entity elects not to undertake a public tender process, the entity must provide an explanation to shareholders in its annual report as to why this has not occurred.</li> </ul> <p>The committee further recommends that such a tender process be implemented by 2022 for any entity that has had the same auditor for a continuous period of ten years since 2012.</p>	<p>No specific actions will be undertaken until the Government responds to be recommendation.</p>
8.	<p>The committee recommends that the Financial Reporting Council oversee a formal review, to report by the end of the 2020–21 financial year, of the sufficiency and effectiveness of reporting requirements under the Australian standards in relation to:</p> <ul style="list-style-type: none"> <li>- the prevention and detection of fraud; and</li> <li>- management's assessment of going concern.</li> </ul>	<p>In progress:</p> <ul style="list-style-type: none"> <li>- The AASB and AUASB adopt standards issued by the International Accounting Standards Board (IASB) and the International Audit and Assurance Standards Board (IAASB) and therefore are monitoring international developments.</li> </ul>

**PJC Regulation of Auditing in Australia - Status of recommendations**

	Recommendation	Status
		<ul style="list-style-type: none"> <li>- The IAASB have commenced projects to consider the current auditing standards for fraud and going concern. However these are unlikely to be completed until at least 2024.</li> <li>- Whilst the IAASB and the AASB have raised going concern with the IASB previously, they have not agreed to commence a project to look at the financial statement disclosure requirements. The AASB are preparing a thought leadership paper on going concern disclosure requirements and how they may be enhanced with the intention to share this with the IASB.</li> <li>- Fraud is not a project being considered by the IASB.</li> <li>- The international progress is slow and the AASB and the AUASB may need to consider moving ahead of international if the Australian government accept this recommendation with an implementation date sooner than can be achieved by waiting for international developments.</li> <li>- This will be monitored going forward.</li> </ul>
9.	<p>The committee recommends that the <i>Corporations Act 2001</i> be amended such that entities required to have their financial reports audited under the Act must establish and maintain an internal controls framework for financial reporting. In addition, such amendments should require that:</p> <ul style="list-style-type: none"> <li>- management evaluate and annually report on the effectiveness of the entity's internal control framework; and</li> <li>- the external auditor report on management's assessment of the entity's internal control framework.</li> </ul>	<p>Whilst this recommendation is included in the final report the PJC's recommendation is for the Government to consider both appropriate timelines and thresholds (entity size and type) given the additional costs that this recommendation would cause. No work will commence on this recommendation until the Government responds to this recommendation.</p>
10.	<p>The committee recommends that the Australian Government take appropriate action to make digital financial reporting standard practice in Australia.</p>	<p>ASIC is holding a webinar on 8 June 2021 to raise awareness.</p>



## AUASB Agenda Paper

<b>Project:</b>	<b>AUASB Framework and Processes Plan</b>	<b>Meeting:</b>	8-9 June 2021
<b>Topic:</b>	<b>ASA 100 and ASA 101 – Preamble to AUASB Standards</b>	<b>Agenda Item:</b>	<b>3.0</b>
<b>Strategic Objectives:</b>	1 & 2	<b>Decision-Making:</b>	Review and Approval of Exposure Draft
<b>ATG Staff:</b>	Johanna Foyster	<b>Project Status:</b>	Exposure Draft

### A. Action Required and Decisions to be Made

- 1 For the AUASB to:
  - (a) review and approve to issue Exposure Draft ED 2021-2 *Proposed Auditing Standard ASA 101 Preamble to AUASB Standards* (ED 02/21) - see **Agenda Item 3.1**; and
  - (b) undertake a 'fatal flaw' review of the draft Explanatory Memorandum to ED 02/21 - see **Agenda Item 3.3**.

### B. AUASB Technical Group (ATG) Recommendations Overview and Questions for the Board

Question for the Board	ATG Recommendations Overview
1. Does the AUASB agree with the ATG's proposed revised ASA 101, included at <b>Agenda Item 3.1</b> ?	Approve to issue <b>Exposure Draft ED 02/21</b> for a 30-day comment period.
2. Does the AUASB support the ATG's draft Explanatory Memorandum document that will accompany ED 02/21, included at <b>Agenda Item 3.3</b> ?	Provide feedback on the <b>Explanatory Memorandum to ED 02/21</b> .

### C. Background

- 2 In May 2020, the AUASB approved a project to update the AUASB's Due Process Framework and related policies and framework pronouncements. The AUASB's Preambles were specifically identified in the plan for review and updating.
- 3 The AUASB currently has two Preamble pronouncements - *ASA 100 Preamble to AUASB Standards* (issued 2006) and *ASA 101 Preamble to Australian Auditing Standards* (issued 2009). ASA 100 and ASA 101 together serve as the primary interpretive documents for AUASB Standards. AUASB Standards are to be read and applied in conjunction with the AUASB's Preambles.
- 4 At the **September 2020 AUASB meeting**, the AUASB supported a proposal to replace ASA 100 and ASA 101 with a single comprehensive preamble that will apply to all AUASB Standards; that is, to expand the scope of ASA 101 to also include standards other than Auditing Standards.
- 5 At the **April 2021 AUASB meeting**, the Board considered and provided feedback on a first draft of the proposed revised ASA 101 – refer to **Agenda Item 4** of this meeting for further information on matters raised for Board consideration and discussion.

## D. Matters for Board Consideration

- 6 The ATG considered the Board's feedback from the April 2021 meeting to finalise the proposed standard. A mark-up of further changes made to extant ASA 101 subsequent to the April 2021 AUASB meeting, is included at **Agenda Item 3.2**.
- 7 As flagged at the April 2021 AUASB meeting, the ATG has engaged the services of an independent legal firm to review the proposed amendments to ASA 101 and to provide legal advice on:
- the necessary changes to ASA 101 as a result of the expansion of application to standards other than Australian Auditing Standards;
  - the likelihood of any unintended consequences flowing from the proposed amendments to ASA 101; and
  - specific matters identified as part of the ATG's review of the preambles and Board feedback from the April 2021 meeting.
- 8 The proposed revised ASA 101 (ED 02/21) included at Agenda Item 3.1 has been reviewed by the legal firm, and their feedback have been addressed in the attached documents. A copy of the legal advice is attached at **Agenda Item 3.4 (BOARD ONLY)**.
- 9 Overall, the legal advice supports the general approach to the ATG's update of the Preamble to AUASB Standards.

## Specific Matters raised by the AUASB at the April 2021 AUASB meeting (or by individual Board members before the April 2021 meeting) and ATG Response

### *Operative Date – ED 02/21 paragraph 2*

- 10 A Board member raised a question about potential unintended consequences where early adoption of the revised ASA 101 is permitted. Where an assurance practitioner decides to adopt the revised standard before its operative date of 1 October 2021, this will require disclosure in the audit report (ED 02/21, paragraphs A34-A35).
- 11 The legal firm has considered the proposed paragraph 2 of ED 02/21 in the context of the related explanatory material set out in paragraphs A34-A35, and recommends the following:
- That the AUASB consider aligning the issue date with the operative date of the standard.
  - That the revised ASA 101 not be 'silent' on the ability of assurance practitioners to adopt the proposed standard earlier than the operative date. Although the default position under the revised ASA 101 and the Corporations Act is that a standard can be applied prior to its operative date, assurance practitioners may not be aware of this. Explicitly allowing (or disallowing) early adoption will bring additional clarity to how and when practitioners can adopt AUASB Standards.
  - Currently, there is a gap in the AUASB standards in that ASA 100 has been repealed and no longer has the force of law. Permitting the early adoption of the revised ASA 101 (which incorporates key aspects of ASA 100) will ensure there is a legally binding substitute in place to partly fill this gap.

### *ATG Response*

- 12 No amendments made to the April 2021 version of the proposed standard, which explicitly states that early adoption is permitted.
- 13 The ATG does not consider this to be a significant issue as it is very unlikely that the final standard will be issued before mid-September 2021 - refer to the timeline for finalising the revised ASA 101 outlined in Section F of this paper. Furthermore, the standard will only become a legislative instrument once registered on the Federal Register of Legislation, which generally happens within 2 days of being lodged with the OPC. An instrument commences on the start of the day after it is registered. Therefore, the issue date and operative date of the proposed standard will be very close.

### *Purpose and Scope of Revised ASA 101 - ED 02/21 paragraph 3*

- 14 A Board member suggested replacing the word "intentions" with "expectations". The ATG sought legal advice on the preferred wording for paragraph 3 of ED 01/21 which sets out the scope and purpose of the Preamble.

- 15 According to the legal advice, both words could be used interchangeably as they carry the same meaning. However, legal advice states there is a risk that the reference to subjective “intentions” or “expectations” within paragraph 3 could diminish the enforceability of the guidance and that this phrasing adds no probative strength to the standards themselves. To avoid the issues that arise from a subjective standard, it was recommended that paragraph 3 makes it clear that the AUASB Standards are to be understood in an objective manner.

## *ATG Response*

- 16 The ATG agrees with this advice and has amended paragraph 3 of ED 02/21 as follows:  
“This Auditing Standard sets out the expectations of the AUASB as to how AUASB Standards are to be understood, interpreted and applied.”

## ***Documentation Requirements when a Requirement in a Standard is not relevant - Extant ASA 101 paragraph 12; ED 02/21 paragraphs A41-A43***

- 17 At the April 2021 AUASB meeting, the AUASB endorsed the ATG’s proposal to move the “Requirements” set out in paragraph 11 and 12 of the extant ASA 101 to the “Application and Other Explanatory Material” section of the proposed revised ASA 101. The ATG does not consider paragraphs 11 and 12 to be requirements in addition to existing requirements contained in other AUASB Standards. The ATG’s position is that these paragraphs provide further explanation and clarification of the application of requirements contained in AUASB Standards.
- 18 Paragraph 12 of extant ASA 101 includes a specific requirement describing the circumstances when an auditor is not required to document the reason(s) why a requirement is not relevant. At the April 2021 AUASB meeting, a Board member queried whether relegating the requirement in paragraph 12 of extant ASA 101 to application and other explanatory material in the revised ASA 101 may create any future enforcement challenges.
- 19 The ATG has obtained independent legal advice on this matter that supports the position that paragraph 12 of extant ASA 101 is more appropriately placed in the Application and Other Explanatory Material section of ED 02/21. The basis for this position is that the difference in scope between extant ASA 101 and ED 02/21 determines the types of matters to be contained within the primary section of each standard. In light of the scope of extant ASA 101, mandatory requirements, such as paragraph 12, could be appropriately placed within the primary section of extant ASA 101. In contrast, the scope of the proposed revised ASA 101 does not provide for mandatory requirements to be included within the primary section of ED 02/21. For further background, refer to the Explanatory Memorandum to ED 02/21 paragraphs 16(b) and 16(d).

## *ATG Response*

- 20 No amendments made to the April 2021 version of the proposed standard.

## ***Compliance and Enforcement – ED 02/21, paragraph A7***

- 21 An AUASB member found inclusion of the words “The extent of compliance required” in paragraph A7 confusing in light of preceding paragraphs that gave a clear message that the assurance practitioner have to comply with the mandatory requirements.
- 22 The ATG has requested the legal firm to review paragraph A7 in light of the Board member’s comments. Advice obtained agrees that the current wording has the unintended implication that full compliance with the AUASB Standards is not required.

## *ATG Response*

- 23 The ATG has worked with the legal firm to come up with revised wording to address the concerns of the AUASB member. See marked up changes to paragraph A7 of ED 02/21 at **Agenda Item 3.2**.
- 24 Subsequent to the revised Preamble being approved the ATG will need to update the wording of the *Foreword to AUASB Pronouncements* (paragraph 6) and the *Due Process Framework for Developing, Issuing and Maintaining AUASB Pronouncements and Other Publications* (paragraph 17) to align with the final wording for paragraph A7 as approved by the Board.

## **AUASB Drafting Conventions - ED 02/21 paragraph A55**

- 25 At the April 2021 AUASB meeting, the AUASB supported the ATG's proposal not to carry forward to the revised preamble the explanatory material included in the extant ASA 100 on words and phrases used in AUASB Standards on the basis that most of this material no longer continue to be relevant to AUASB Standards which have been redrafted in "clarity" format and reissued in 2009. Refer to the Explanatory Memorandum to ED 02/21, paragraph 16(e)(iii).
- 26 The ATG asked the legal firm to review paragraph A55 of ED 02/21 entitled "AUASB Drafting Conventions" and to consider whether there are any unintended consequences of not including all of the explanatory material previously set out in paragraph 48 of ASA 100.
- 27 Legal advice affirmed paragraph A55 of the proposed revised ASA 101 contains an appropriate list of the interpretative principles to be used when reading an AUASB Standard; however, the recommendation was to retain the interpretative guidance in paragraph 48(c) of ASA 100 surrounding the use of the word "including" and importantly to expressly state that the use of the word "including" is not exhaustive.

## **ATG Response**

- 28 Added paragraph 48(c) of ASA 100 to paragraph A55 of ED 02/21 – see marked up changes in **Agenda Item 3.2**.

## **E. Conforming Amendments**

- 29 The proposed amendments to ASA 101 will likely require further conforming amendments to be made to the following Auditing Standards once the revised preamble has been approved:
- (a) ASA 200 – amendment to align the wording of paragraph A56 with that of its international equivalent.
  - (b) ASA 700 – "Aus" paragraph amendment to require that where an assurance practitioner is conducting an audit of a financial report and the practitioner elects to early adopt an auditing standard made under s336 of the Corporations Act, in accordance with section 336(4), that election must be recorded in the audit report.
- 30 Conforming amendments to other AUASB pronouncements and policies:
- (a) *Foreword to AUASB Pronouncements* – update paragraph 6 to align with paragraph A7 of the revised ASA 101 and replace cross references to ASA 100 and ASA 101 with references to the revised ASA 101.
  - (b) *Due Process Framework for Developing, Issuing and Maintaining AUASB Pronouncements and Other Publications* – update paragraph 17 to align with paragraph A7 of the revised ASA 101 and replace cross references to ASA 100 and ASA 101 with references to the revised ASA 101. Include hyperlinks to the revised Foreword and Preamble, once uploaded on the AUASB website.
- 31 Relevant AUASB Standards will need to be reissued with updated Authority Statements to reference ASA 101 instead of ASA 100.

## **F. Next Steps**

- 32 Complete AUASB Quality Assurance (QA) and other internal processes.
- 33 Finalise the Explanatory Memorandum document to address AUASB feedback.
- 34 Issue ED 02/21 and related Explanatory Memorandum for public comment. ED 02/21 will be open to stakeholders for a 30-day comment period, with a proposed closing date of **31 July 2021** to allow for suitable time to process final changes before the September 2021 AUASB Meeting.

35 Proposed timeline to complete the project:

Action	Timeline (2021)
AUASB consider and <b>approve ED 02/21</b>	June 2021 AUASB meeting
<b>Issue ED 02/21 for a 30-day comment period</b>	Post June AUASB meeting Comments due: 31 July 2021
<b>Consider feedback</b> from public consultation and finalise standard. Prepare <b>Basis for Conclusions</b> document and <b>Explanatory Statement</b> .	August 2021
AUASB <b>approve final standard</b> to issue AUASB <b>approve Amending Standard</b> - amendments to ASA 200 and ASA 700	Seek AUASB approval at September 2021 AUASB meeting Issue final standard mid-September after final QA process
Reissue relevant AUASB Standards with updated Authority Statements to reference ASA 101 instead of ASA 100  Update the AUASB's Due Process Framework and AUASB Foreword to align with, and reference, the revised ASA 101.	September 2021

## G. Attachments to the Agenda Paper

Agenda Item	Description
3.1	ED 02/21 Proposed Revised ASA 101 <i>Preamble to AUASB Standards</i> <b>CLEAN VERSION</b>
3.2	ED 02/21 Proposed Revised ASA 101 <i>Preamble to AUASB Standards</i> <b>MARKED UP FROM APRIL 2021 AUASB MEETING</b>
3.3	Explanatory Memorandum ED 02/21
3.4	Independent Legal Advice in relation to the proposed revision of AUASB Preamble Standards <b>BOARD ONLY</b>

**EXPOSURE DRAFT**

**ED 2021-2**  
(June 2021)

# **Proposed Auditing Standard ASA 101**

## ***Preamble to AUASB 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 31 July 2021. Comments should be addressed to:

The Chairman  
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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**CONFORMITY WITH INTERNATIONAL STANDARDS ON AUDITING**

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## PREFACE

### **Reasons for Issuing ED 2021-2**

The AUASB issues Exposure Draft ED 2021-2 of proposed Auditing Standard ASA 101 *Preamble to AUASB Standards* pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is an independent 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.

### **Main Proposals**

The AUASB is proposing to replace Auditing Standard ASA 100 *Preamble to AUASB Standards* (F2006L01321) and Auditing Standard ASA 101 *Preamble to Australian Auditing Standards* (F2009L04062) with an updated comprehensive Preamble that will apply to all AUASB Standards (Revised ASA 101).

The Explanatory Memorandum accompanying this proposed Auditing Standard provides an overview of the proposed amendments to the current ASA 101.

### **Proposed Operative Date**

It is intended that this proposed Auditing Standard will be operative for engagements with financial reporting periods commencing on or after 1 October 2021. Early adoption of this Auditing Standard is permitted prior to this date.

### **Main changes from existing ASA 101 *Preamble to Australian Auditing Standards* (October 2009)**

The main differences between this proposed Auditing Standard and the Auditing Standard that it supersedes, ASA 101 *Preamble to Australian Auditing Standards* (October 2009), are included in the Explanatory Memorandum.

## **Request for Comments**

Comments are invited on this Exposure Draft of the proposed re-issuance of ASA 101 no later than 31 July 2021.

The AUASB is seeking comments from stakeholders on the following questions:

1. Do you support the introduction of the proposed revised ASA 101? If not, why not?  
The AUASB prefers that respondents express a clear opinion on whether the proposed Auditing Standard, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on the matters below. The AUASB regards both supportive and critical comments as essential to a balanced review of the proposed Auditing Standard.
2. 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?
3. Are there any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
4. What, if any, are the additional significant costs to/benefits for assurance practitioners and the business community arising from compliance with the main changes to the requirements of this proposed standard? If significant costs are expected, the AUASB would like to understand:
  - a. Where these costs are likely to occur;
  - b. The estimated extent of costs, in percentage terms (relative to fees); and
  - c. Whether expected costs outweigh the benefits to the users of assurance services?
6. Are there any other significant public interest<sup>1</sup> matters that stakeholders wish to raise?

The AUASB asks that comments are sufficiently detailed and include whether stakeholders agree or do not agree with the proposed amendments. The AUASB welcomes any other comments which are not specifically addressed by the questions above.

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<sup>1</sup> The AUASB's *Public Interest Framework for the Development of AUASB Pronouncements* expands upon what the "public interest" means to the AUASB and provides a useful frame of reference for the AUASB to assess whether its standard-setting process is appropriate and responsive to the public interest. See Appendix 1 of the AUASB's *Due Process Framework for Developing, Issuing and Maintaining AUASB Pronouncements and Other Publications*.

**AUTHORITY STATEMENT**

Auditing Standard ASA 101 *Preamble to AUASB Standards* is set out in paragraphs 1 to A55.

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 101 *Preamble to AUASB 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).

Where relevant, the AUASB has aligned the wording of this Auditing Standard with the IAASB's *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

## **AUDITING STANDARD ASA 101**

### *Preamble to AUASB Standards*

#### **Application**

1. This Auditing Standard applies to:
  - (a) an audit of a financial report for a financial year, or an audit or review of a financial report for a half-year, in accordance with the *Corporations Act 2001* (Corporations Act); (Ref: Para. A5-A6; A30-A32)
  - (b) an audit or review of a financial report, or a complete set of financial statements, for any other purpose;
  - (c) an audit or review of other financial information;
  - (d) other assurance engagements;
  - (e) related services engagements; and
  - (f) a firm required to comply with ASQM 1.<sup>2</sup>

#### **Operative Date**

2. This Auditing Standard is operative for engagements with financial reporting periods commencing on or after 1 October 2021. Early adoption of this Auditing Standard is permitted prior to this date.

#### **Introduction**

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

3. This Auditing Standard sets out how AUASB Standards are to be understood, interpreted and applied.
4. AUASB Standards are to be read and applied in conjunction with this Auditing Standard. (Ref: Para. A1-A2)

##### **Standards issued by the AUASB** (Ref: Para. A3-A25)

5. The AUASB derives its functions and powers under section 227B of the *Australian Securities and Investments Commission Act 2001*. The AUASB:
  - (a) makes Auditing Standards under section 336 of the Corporations Act for the purposes of the corporations legislation;<sup>3</sup> and
  - (b) formulates auditing and assurance standards for other purposes.<sup>4</sup>

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<sup>2</sup> Or ASQC 1, as applicable. ASQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Reports and Other Financial Information, or Other Assurance or Related Services Engagements*, issued in March 2021, replaces Auditing Standard ASQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements* from 15 December 2022.

<sup>3</sup> Pursuant to section 227B(1)(a) of the ASIC Act.

<sup>4</sup> Pursuant to section 227B(1)(b) of the ASIC Act.

6. ‘Auditing and assurance standards for other purposes’ consists of standards that are designed for subject-specific areas. They include, for example, assurance engagements that relate to:
- reviews (other than a review by the independent auditor of the entity, of interim financial information, including interim financial reports, prepared for other purposes);
  - evaluating the efficiency and/or effectiveness of an entity’s activities;
  - prospective financial information; and
  - the effectiveness of internal controls.
7. The AUASB issues the following types of standards (AUASB Standards) pursuant to its mandate under section 227B of the ASIC Act:
- (a) Australian Standards on Quality Management (ASQMs);<sup>5</sup>
  - (b) Australian Auditing Standards (ASAs);<sup>6</sup>
  - (c) Standards on Review Engagements (ASREs);<sup>7</sup>
  - (d) Standards on Assurance Engagements (ASAEs); and
  - (e) Standards on Related Services (ASRSs).
8. AUASB Standards do not address all the responsibilities of the assurance practitioner<sup>8</sup> that may exist in legislation, regulation or otherwise in connection with engagements that fall within the scope of AUASB Standards.

## **Objective**

9. The objective of the assurance practitioner is to use this Auditing Standard in order to understand, interpret and apply AUASB Standards.

## **Definitions**

10. For the purposes of this Auditing Standard, the following terms have the meanings attributed below:
- (a) Assurance practitioner means an individual, firm<sup>9</sup>, or other organisation, whether in public practice, industry and commerce, or the public sector, conducting assurance engagements or related services engagements<sup>10</sup>.
  - (b) AUASB Standards means standards issued by the AUASB, comprising:
    - (i) Australian Auditing Standards (ASAs) – as defined in paragraph 10(c);

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<sup>5</sup> For legislative purposes, ASQM 1 and ASQM 2 *Engagement Quality Reviews* are included in legislation as “Auditing Standards” – see paragraph 10(d) of this Preamble.

<sup>6</sup> Defined in paragraph 10(c) of this Preamble.

<sup>7</sup> For legislative purposes, ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity* and ASRE 2415 *Review of a Financial Report: Company Limited by Guarantee or an Entity Reporting under the ACNC Act or Other Applicable Legislation or Regulation*, are included in legislation as “Auditing Standards” – see paragraph 10(d) of this Preamble.

<sup>8</sup> Defined in paragraph 10(a) of this Preamble.

<sup>9</sup> Firm means a sole practitioner, partnership, corporation or other entity of assurance practitioners, or public sector equivalent. The definition of “firm” in relevant ethical requirements may differ from the definition set out in this Auditing Standard.

<sup>10</sup> Related services engagements include engagements to perform agreed-upon procedures. The term ‘assurance practitioner’ is referred to in ASRS 4400 *Agreed-Upon Procedures Engagements* as ‘practitioner’.

- (ii) Standards on Review Engagements (ASREs);
  - (iii) Standards on Assurance Engagements (ASAEs); and
  - (iv) Standards on Related Services (ASRSs).
- (c) Australian Auditing Standards (ASAs) means the suite of auditing standards issued by the AUASB, comprising:
- (i) Auditing Standards made under section 336 of the Corporations Act – as defined in paragraph 10(d);
  - (ii) *ASA 805 Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*; and
  - (iii) *ASA 810 Engagements to Report on Summary Financial Statements*.
- (d) Auditing Standards means auditing standards made under section 336 of the Corporations Act, and include:
- (i) ASQM 1;
  - (ii) *ASQM 2 Engagement Quality Reviews*;
  - (iii) *ASRE 2410 Review of a Financial Report Performed by the Independent Auditor of the Entity*; and
  - (iv) *ASRE 2415 Review of a Financial Report: Company Limited by Guarantee or an Entity Reporting under the ACNC Act or Other Applicable Legislation or Regulation*.

## **Requirements**

11. The assurance practitioner shall apply AUASB Standards in conjunction with paragraphs 12 and 13 of this Auditing Standard.

### **Authority of the Paragraphs in AUASB Standards** (Ref: Para. A26-A55)

#### **Mandatory Components** (Ref: Para. A28-A44, A55)

12. The assurance practitioner shall apply the mandatory components of AUASB Standards relevant to the engagement. The mandatory components are included in each AUASB Standard under the headings listed below:
- (a) Application. (Ref: Para. A28-A32)
  - (b) Operative Date. (Ref: Para. A33-A35)
  - (c) Objective(s). (Ref: Para. A36)
  - (d) Definition(s). (Ref: Para. A37)
  - (e) Requirements. (Ref: Para. A38-A44)

#### **Explanatory Material** (Ref: Para. A45-A55)

13. The assurance practitioner shall have an understanding of the entire text of an AUASB Standard, including its application and other explanatory material, to understand its objectives and to apply the mandatory components of the standard properly. The explanatory material is included in each standard under the headings listed below (where applicable):

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- (a) Conformity with International Standards. (Ref: Para. A45-A49)
- (b) Application. (Ref: Para. A28, A32).
- (c) Introduction. (Ref: Para. A50)
- (d) Application and Other Explanatory Material. (Ref: Para. A51-A53)
- (e) Appendices. (Ref: Para. A54)

Explanatory material does not create or extend mandatory components.

## **Application and Other Explanatory Material**

### **Scope of this Auditing Standard** (Ref: Para. 3-4)

#### **“Authority Statement” included in AUASB Standards**

- A1. This Auditing Standard forms an important part of the legal and regulatory framework of AUASB Standards. AUASB Standards are to be read in conjunction with this Auditing Standard.
- A2. All AUASB Standards contain an “Authority Statement”. The purposes of the Authority Statement are to:
- (a) link the issuance of each individual AUASB Standard to the mandating legislation;
  - (b) identify the paragraphs that comprise the AUASB Standard; and
  - (c) set out the requirement to read the AUASB Standard in conjunction with this Auditing Standard.

#### **Standards issued by the AUASB** (Ref: Para. 5-8)

- A3. The AUASB issues the following types of standards pursuant to its mandate under section 227B of the ASIC Act:
- (a) Australian Standards on Quality Management (ASQMs)  
  
ASQMs<sup>11</sup> apply to firms in respect of all engagements to which AUASB Standards apply.  
  
The authority of ASQMs is set out in the introduction to each ASQM.
  - (b) Australian Auditing Standards (ASAs)  
  
ASAs, whilst developed in the context of financial report audits, are to be applied also, as appropriate, to all audits of other historical financial information.  
  
The authority of the suite of ASAs is set out in ASA 200<sup>12</sup>. ASA 200 deals with the auditor’s overall responsibilities when conducting an audit of a financial report in accordance with ASAs. Specifically, it sets out the overall objectives of the auditor, and explains the nature and scope of an audit designed to enable the auditor to meet those objectives. It also explains the scope, authority and structure of the ASAs, and includes requirements establishing the general responsibilities of the auditor applicable in all audits, including the obligation to comply with the ASAs.  
  
The ASAs, taken together, provide the standards for the auditor’s work in fulfilling the overall objectives of the auditor. The ASAs deal with the general responsibilities of the auditor, as well as the auditor’s further considerations relevant to the application of those responsibilities to specific topics.

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<sup>11</sup> For legislative purposes, ASQM 1 and ASQM 2 are included in legislation as “Auditing Standards”.

<sup>12</sup> See ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

(c) Standards on Review Engagements (ASREs)

ASREs<sup>13</sup> are to be applied to the review of a financial report and the review of other historical financial information.

The authority of ASREs is set out in the introduction to each ASRE.<sup>14</sup>

(d) Standards on Assurance Engagements (ASAEs)

ASAEs are to be applied to assurance engagements dealing with subject matters other than historical financial information.<sup>15</sup>

ASAE 3000<sup>16</sup> explains the scope, authority and structure of the ASAEs, and includes requirements regarding the conduct of an assurance engagement in accordance with ASAEs.<sup>17</sup>

Where a subject-matter specific ASAE is relevant to the subject matter of a particular engagement, that ASAE applies in addition to ASAE 3000. The introduction to each subject-matter specific ASAE sets out the relationship of the ASAE with ASAE 3000.

(e) Standards on Related Services (ASRSs)

ASRSs are to be applied when an assurance practitioner is engaged to undertake engagements other than assurance engagements covered by ASAs, ASREs or ASAEs.<sup>18</sup>

The authority of ASRSs is set out in the introduction to each ASRS.<sup>19</sup>

A4. The scope, operative date and any specific limitation of the applicability of a specific AUASB Standard, is made clear in each standard.

**Auditing Standards made under Section 336 of the Corporations Act**

A5. Auditing Standards made under section 336 of the Corporations Act apply to:

- (a) an audit of a financial report for a financial year, or an audit or review<sup>20</sup> of a financial report for a half-year, prepared in accordance with Part 2M.3 of the Act;
- (b) an audit conducted under Part 7.8 of the Act;
- (c) an audit of a financial report, or a complete set of financial statements, prepared for any other purpose;

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<sup>13</sup> For legislative purposes, ASRE 2410 and ASRE 2415 are included in legislation as “Auditing Standards”:

<sup>14</sup> For example, see ASRE 2400 *Review of a financial Report Performed by an Assurance Practitioner Who is Not the Auditor of the Entity*, paragraphs 9-12.

<sup>15</sup> Examples of such subject matters include the efficiency and/or effectiveness of an entity’s activities, prospective financial information and the effectiveness of internal controls. The AUASB’s *Framework for Assurance Engagements*, which defines and describes the elements and objectives of an assurance engagement, provides the context for understanding ASAEs.

<sup>16</sup> See ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.

<sup>17</sup> See ASAE 3000, “Introduction” (paragraphs 1-8) and “Conduct of an Assurance Engagement in Accordance with ASAEs” (paragraphs 14-20).

<sup>18</sup> Examples of financial and non-financial subject matters on which Standards on Related Services may be applied include: Agreeing the eligibility of expenditures claimed from a funding program; Recalculating revenues for determining royalties, rent or franchise fees based on a percentage of revenues; Confirming the calculation of capital adequacy ratios for regulatory authorities; Observation of the destruction of fake or defective goods reported to a regulatory authority; and Tracing data generating processes for lottery draws reported to a regulatory authority.

<sup>19</sup> For example, see ASRS 4400, paragraphs 7-10. Where this information is not included in the introduction of an ASRS, for example ASRS 4450 *Comfort Letter Engagements*, relevant terms are to be interpreted in a directly analogous way to how they are explained in the context of ASRS 4400.

<sup>20</sup> For legislative purposes, ASRE 2410 and ASRE 2415 are included in legislation as “Auditing Standards”.

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- (d) a review, by the independent auditor of the entity, of a financial report, or a complete set of financial statements, comprising historical financial information, for any other purpose; and
  - (e) a firm required to comply with ASQM 1.
- A6. Although Auditing Standards are written mainly in the context of an external audit of a financial report,<sup>21</sup> they apply also, adapted as necessary, to the audit of other historical financial information.

**Compliance and Enforcement**

- A7. AUASB Standards are not legally binding in all contexts:
- Standards made and issued under section 336 of the Corporations Act for the purposes of the corporations legislation have the status of law.<sup>22</sup> Where engagements covered by these standards are undertaken for the purposes of complying with the Corporations Act, full compliance is required as a matter of law.<sup>23</sup>
  - Auditing and assurance standards may also be issued or used for other purposes. Where auditing and assurance standards are used for purposes other than complying with the Corporations Act, compliance with those standards may not be required as a matter of law. There are, however, circumstances in which compliance is required by other legislation, regulatory or contractual arrangements.
- A8. Auditing Standards issued by the AUASB under the Corporations Act, are legally enforceable by the Australian regulator – the Australian Securities and Investments Commission (ASIC). ASIC conducts regular inspection programmes as an integral part of its enforcement responsibilities.
- A9. Through the standards issued by the Accounting Professional & Ethical Standards Board (APESB), members of the Australian Professional Accounting Bodies are compelled to comply with the requirements of AUASB Standards.<sup>24</sup>
- A10. Member compliance is enforced through the inspection programmes of the Professional Accounting Bodies, which are also responsible for member disciplinary action.

**Type of Entity**

- A11. AUASB Standards are:
- (a) neutral with respect to the sector and size of the entity subject to the engagement; and
  - (b) intended to be applied, as appropriate, to all audit, review, assurance and related service engagements conducted by an external firm in both the public and private sectors.
- A12. The AUASB generally does not set industry or sector specific standards but may from time to time produce industry or sector specific guidance materials. Where necessary, entity sector

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<sup>21</sup> Reference to a ‘financial report’ includes not only a financial report as defined under Part 2M.3 of the Act, but also a financial report prepared for other purposes. Financial reports required by Part 2M.3 of the Corporations Act are:

- the annual financial report; and
- the half-year financial report (for certain entities).

<sup>22</sup> These standards are classified as disallowable legislative instruments under the *Legislation Act 2003*. The AUASB has adopted certain drafting principles in making Auditing Standards under the Australian regulatory environment, wherein the Auditing Standards are legally enforceable and registered as legislative instruments under the *Legislation Act 2003*.

<sup>23</sup> Section 307A of the Corporations Act requires auditors to conduct audits and reviews of financial reports prepared under Part 2M.3 of the Act in accordance with Auditing Standards.

<sup>24</sup> See APES 210 *Conformity with Auditing and Assurance Standards*, issued by the APESB.

and size considerations are included, and identified, in the body of the relevant AUASB Standard.

- A13. AUASB Standards do not take into account any specific circumstances affecting entities that are subject to the engagement.

#### *Public Sector Engagements*

- A14. AUASB Standards are relevant to engagements in the public sector. When appropriate, additional considerations specific to public sector entities are included within the “Application and Other Explanatory Material” section of each standard.
- A15. The responsibilities of public sector assurance practitioners may be affected by the mandate applying to the engagement, or by obligations on public sector entities arising from law, regulation or other authority (such as ministerial directives, government policy requirements, or resolutions of the legislature), which may encompass a broader scope than an engagement in accordance with the AUASB Standards. These additional responsibilities are not dealt with in the AUASB Standards. They may be dealt with in guidance developed by government audit agencies<sup>25</sup>.

#### **Applying AUASB Standards**

##### *Professional Judgement*

- A16. Professional judgement is essential to the proper conduct of engagements that fall within the scope of AUASB Standards. This is because interpretation of relevant ethical requirements and relevant AUASB Standards and the informed decisions required throughout the engagement cannot be made without the application of relevant training, knowledge and experience to the facts and circumstances.<sup>26</sup>

#### **Ethical Principles and Quality Management Standards**

- A17. Compliance with ethical principles, including independence requirements, and quality management within firms that perform engagements to which AUASB Standards apply, are widely recognised as being in the public interest and an integral part of a high-quality engagement.<sup>27</sup>

##### *Relevant Ethical Requirements*

- A18. References to compliance with relevant ethical requirements are included in certain requirements and explanatory material paragraphs in AUASB Standards. AUASB Standards are to be read in conjunction with relevant ethical requirements, as defined in ASA 102.<sup>28</sup> Law, regulation or relevant ethical requirements may establish responsibilities for the assurance practitioner beyond those described in AUASB Standards.

##### *Quality Management Standards*

- A19. ASQM 1 deals with a firm’s responsibilities to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements.
- A20. Engagement quality reviews form part of the firm’s system of quality management and:

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<sup>25</sup> In Australia the term “government audit agencies” refers to State, Territory or Commonwealth Auditors-General.

<sup>26</sup> The term “professional judgement” is defined in the AUASB Glossary in the context of different types of AUASB Standards. For assurance engagements, see *Framework for Assurance Engagements*, paragraphs 56-60. For related services engagements, see ASRE 4400, paragraphs 13(j) and 18.

<sup>27</sup> For further details, refer to *Framework for Assurance Engagements*, paragraphs 5-9.

<sup>28</sup> See ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements*.

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- (a) ASQM 1 deals with the firm’s responsibility to establish policies or procedures addressing engagements that are required to be subject to engagement quality reviews.
- (b) ASQM 2 deals with the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review.

A21. AUASB Standards are premised on the basis that a firm is subject to the ASQMs, and include requirements regarding quality management at the engagement level.<sup>29</sup>

**Amendments to AUASB Standards**

A22. AUASB Standards may require amendment for a variety of reasons, such as consequential and conforming amendments that is required as a result of changes made to other AUASB Standards.

*Consequential and Conforming Amendments*

A23. As standards made under section 336 of the Corporations Act are legislative instruments, they can only be amended by another legislative instrument. An “Amending Standard” is a legislative instrument made by the AUASB for the sole purpose of amending other legislative instruments (referred to as the “principal standard”). Amending Standards provide an efficient way of processing amendments which affect a number of standards without reissuing all the standards affected.

*Compilations*

A24. The compiled version of a standard reflects the content of a standard, considering all amendments that have become effective since the principal standard was originally made. Compilations are a requirement of the *Legislation Act 2003* and are required to be lodged with the Office of Parliamentary Counsel for registration on the Federal Register of Legislation. A compilation is not a legislative instrument.<sup>30</sup>

A25. Where the AUASB issues a compiled version of a standard:

- (a) the title page of the standard indicates that it is a compiled version of the standard and shows the date of the compilation and the relevant Amending Standards that have been taken into account;
- (b) a “Compilation Details” section is included in the standard which includes the following information:
  - (i) a “Table of Standards”, which sets out details of both the principal standard and subsequent Amending Standards, including the dates of both the principal and Amending Standards (date made, operative date and date registered on the Federal Register of Legislation);
  - (ii) a “Table of Amendments”, which provides details of amendments to the principal standard (paragraph of standard affected, how affected and a paragraph reference to the relevant Amending Standard); and
  - (iii) a statement that the compilation is not a separate Auditing Standard made by the AUASB but a representation of the relevant Standard which incorporates the original standard and subsequent amendments.

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<sup>29</sup> For example, see ASA 220 *Quality Management for an Audit of Financial Statements*.

<sup>30</sup> For example, a standard might have a principal version issued in 2015 amended by Amending Standards (legislative instruments) that become effective, one each year, from 2016. Therefore, in 2020 the compiled version of the standard will reflect the amendments effective from 2016 through to 2020.

- (c) the Operative Date paragraph in the standard includes a reference to the Compilations Details section of the standard, for details about the operative dates of paragraphs changed or added by an Amending Standard. (Ref: Para. A33(a))

**Authority of the Paragraphs in AUASB Standards** (Ref: Para. 12-13)

- A26. The paragraphs in AUASB Standards do not have equal authority. AUASB Standards consist of paragraphs that are either:
- (a) mandatory components; or
  - (b) explanatory material.
- A27. Where an AUASB Standard does not include specific information to explain the status and authority of the paragraphs included within the standard, the terms explained below (for example, “Objectives”, “Requirements”, “Application and Other Explanatory Material”), are to be interpreted in a directly analogous way to how they are explained in the context of financial report audits in ASA 200.

**Mandatory Components** (Ref: Para. 12)

*“Application” Paragraphs* (Ref: Para. 12(a), 13(b))

- A28. Each AUASB Standard contains a mandatory “Application” paragraph. The standard may also include an additional “Application” paragraph that forms part of the explanatory material of the standard, to describe other engagements the standard may be applied to, adapted as necessary.
- A29. The “Application” paragraph or paragraphs of a standard identify the scope of the standard.

Engagements under the Corporations Act (Ref: Para. 1(a); A5-A6)

- A30. Auditing Standards made under section 336 of the Corporations Act<sup>31</sup> contain a mandatory “Application” paragraph (shown as paragraph “Aus 0.1”) relating 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; and
  - (b) an audit of a financial report, or a complete set of financial statements, for any other purpose.
- A31. The “Application” paragraph in each Auditing Standard that refers to audits or reviews conducted in accordance with the Corporations Act applies specifically to:
- (d) an audit or a review conducted under Part 2M.3 of the Act; and
  - (e) an audit conducted under Part 7.8 of the Act.
- A32. Auditing Standards may also include an additional “Application” paragraph (shown as paragraph “Aus 0.2”) that forms part of the explanatory material of the standard to explain that, although the Auditing Standards are written mainly in the context of an audit of a financial report, they apply also, adapted as necessary, to the audit of other historical financial information.

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<sup>31</sup> With the exception of ASA 101, ASA 102, ASQM 1, ASQM 2, ASRE 2410 and ASRE 2415.

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*Operative Date* (Ref: Para. 12(b))

- A33. The operative date stipulates the date from which the AUASB Standard is to be applied. The operative date is stated in relation to a financial reporting period. The requirements of an AUASB Standard remain in force until:
- (a) the operative date of any amendment to those requirements (Ref: Para. A22-A25));
  - (b) in relevant circumstances, the early adoption of such amendments; or
  - (c) the AUASB Standard is withdrawn by the AUASB.
- A34. Unless otherwise stated in an AUASB Standard, the assurance practitioner is permitted to apply a standard before the operative date specified therein. Where an AUASB Standard is early adopted, all relevant conforming and consequential amendments must also be early adopted.
- A35. Where an assurance practitioner is conducting an audit of a financial report and elects to early adopt an auditing standard made under section 336 of the Corporations Act, in accordance with section 336(4), that election must be recorded in the audit report.

*Objective(s)* (Ref: Para. 12(c))

- A36. Each AUASB Standard contains an objective or objectives which provide the context in which the requirements of the standard are set and establishes the desired outcome to be achieved by the assurance practitioner. The proper application of the requirements in the standard is expected to provide a sufficient basis for the practitioner's achievement of the objective(s).

*Definitions* (Ref: Para. 12(d))

- A37. Definitions contained within AUASB Standards, and/or contained within the *AUASB Glossary* (as issued from time to time), provide a description of the meanings attributed to certain terms for the purposes of the AUASB Standards. These definitions are provided for consistent application and interpretation of standards, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. The *AUASB Glossary* contains a complete listing of terms defined in AUASB Standards.

*Requirements* (Ref: Para. 12(e))

- A38. Paragraphs that impose obligations on the assurance practitioner are contained in a separate "Requirements" section of each standard and expressed using the word "shall". Requirements are designed to enable the assurance practitioner to meet the stated objective(s) of an AUASB Standard. In certain circumstances, requirements are legally binding and enforceable.
- A39. The assurance practitioner applies the requirements in the context of the other material included in the AUASB Standard (for example, introductory material, definitions and application and other explanatory material). The entire text of an AUASB Standard, therefore, is relevant to an understanding of the objectives stated in an AUASB Standard and the proper application of the requirements of the standard. Although the assurance practitioner has a responsibility to consider the entire text of the standard in carrying out the engagement, application and explanatory material does not in itself impose a requirement.
- A40. For information on how the requirements in AUASB Standards are to be applied for:
- (a) audits and reviews of historical financial reports and information – see ASA 200;<sup>32</sup>

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<sup>32</sup> See ASA 200, paragraphs 18-24.

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- (b) assurance engagements other than audits or reviews of historical financial information – see ASAE 3000.<sup>33</sup>

These standards also include requirements and explanatory material on the limited circumstances where the assurance practitioner may judge it necessary to depart from a relevant requirement in a standard.

- A41. The assurance practitioner is required to comply with all AUASB Standards relevant to an engagement. Furthermore, AUASB Standards require compliance with each requirement of a relevant standard unless, in the circumstances of the engagement, the requirement is not relevant because it is conditional and the condition does not exist.<sup>34</sup>
- A42. When, in the circumstances of an engagement:
  - (a) an entire AUASB Standard is not relevant; or
  - (b) a requirement is not relevant because it is conditional and the condition does not exist, there is no requirement to document the reason(s) why the requirement is not relevant.
- A43. However, for audits or reviews conducted in accordance with the Corporations Act, where in rare and exceptional circumstances, factors outside the assurance practitioner's control prevent the practitioner from complying with an essential procedure contained within a relevant requirement, the practitioner is required under ASA 230<sup>35</sup> or ASRE 2410<sup>36</sup>, as applicable, to document:
  - (a) the circumstances surrounding the inability to comply;
  - (b) the reasons for the inability to comply; and
  - (c) justification of how alternative procedures achieve the objectives of the requirement.
- A44. In the case of a review and related services engagement, the assurance practitioner is required to apply the requirements contained only in the specified standard applicable to that engagement, in conjunction with this Preamble to AUASB Standards. There is no requirement to apply the requirements of other AUASB Standards. However, reference to ASAs may be helpful to provide guidance.

**Explanatory Material** (Ref: Para. 13)

*Conformity with International Standards* (Ref: Para. 13(a))

- A45. The Conformity paragraphs explain the relationship of an AUASB Standard with its equivalent international standard issued by the IAASB. An AUASB Standard conforms to the equivalent international standard when:
  - (a) the requirements of the AUASB Standard correspond with those in the equivalent international standard or the AUASB Standard contains additional requirements; and
  - (b) the explanatory material is substantially the same as the equivalent international standard or the AUASB Standard contains additional explanatory material.

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<sup>33</sup> See ASAE 3000, paragraphs 14-19.

<sup>34</sup> See ASA 200, paragraph 22 and ASAE 3000, paragraph 17.

<sup>35</sup> See ASA 230 *Audit Documentation*, paragraph Aus 12.1.

<sup>36</sup> See ASRE 2410, paragraph 7.

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- A46. The Conformity paragraphs in AUASB Standards include necessary differences from the equivalent international standard relating to terminology, referencing and Australian regulatory requirements.<sup>37</sup>
- A47. When an AUASB Standard and the equivalent international standard conform, the Conformity paragraphs contain a statement to this effect.
- A48. When an AUASB Standard and the equivalent international standard are not equivalent, the Conformity paragraphs detail the main differences.
- A49. The Conformity paragraphs in each AUASB Standard assist the assurance practitioner to determine to what extent (if any) compliance with AUASB Standards might enable also the engagement to be conducted in compliance with international standards. It is the responsibility of the assurance practitioner to determine which standards apply to the particular engagement and circumstances. Furthermore, where appropriate, the Conformity paragraphs contain the following sentence:

“Compliance with this Standard enables compliance with the equivalent international standard”.

*Introduction* (Ref: Para. 13(c))

- A50. Introductory material provides context relevant to a proper understanding of an AUASB Standard. Introductory material may include, as needed, such matters as explanation of the:
- purpose and scope of the Standard, including how the Standard relates to other AUASB Standards;
  - subject matter of the Standard; and
  - respective responsibilities of the assurance practitioner and others in relation to the subject matter of the Standard.

*Application and Other Explanatory Material* (Ref: Para. 13(d))

- A51. Included within the requirements section of a standard are references to paragraphs in the “Application and Other Explanatory Material” section of the standard. Such references do not extend or create requirements.
- A52. Where necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying the requirements out. In particular, it may:
- explain more precisely what a requirement means or is intended to cover; and
  - include examples that illustrate how the requirements might be applied and/or provide examples of procedures that may be appropriate in the circumstances.

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 an AUASB Standard.

- A53. Where appropriate, additional considerations specific to public sector and smaller entity engagements are included within the “Application and Other Explanatory Material” section of the standard. These additional considerations assist in the application of the requirements of the standards in conducting such engagements. However, they do not limit or reduce the

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<sup>37</sup> Refer to the *AUASB Policy and Process for International Conformance and Harmonisation of Standards* for details of the principles and process the AUASB applies in considering modifications to IAASB Standards.

**Proposed Auditing Standard ASA 101**  
***Preamble to AUASB Standards***

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responsibility of the assurance practitioner to apply and comply with the requirements of AUASB Standards.

*Appendices* (Ref: Para. 13(e))

A54. Appendices form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related standard or within the title and introduction of the appendix itself.

*AUASB Drafting Conventions* (Ref: Para. 12-13)

A55. The following drafting principles and conventions apply to AUASB Standards:

- (a) The requirements of each AUASB Standard are contained in a separate “Requirements” section of a standard. The requirements of an AUASB Standard are expressed using the word “shall” to denote the obligations an assurance practitioner is required to comply with in achieving the objective or objectives stated in the standard.
- (b) Paragraphs containing application and other explanatory material are designated with the letter “A”.
- (c) The present tense of verbs is used in explanatory material when it is the best form of expression. Use of the present tense does not create or imply requirements. The present tense is used in examples and other explanatory material that relate to professional judgement and professional scepticism.
- (d) Requirements that exist in another AUASB Standard are anchored back to the original requirement (for example, using the phrase “in accordance with”) when repetition or a cross reference is considered necessary for understanding and context.
- (e) Australian additions or modifications to an equivalent IAASB Standard are marked as Australian paragraphs or additional appendices commencing with an “Aus” prefix.
- (f) Deletions from an equivalent IAASB Standard are clearly noted as “Deleted by the AUASB. Refer Aus ...”.
- (g) The extent of differences between an AUASB Standard and its equivalent international standard are detailed in the “Conformity with International Standards” section of the standard.
- (h) The word “including”, as used in AUASB Standards, means a list of items or examples is provided but the list does not purport to contain all relevant items or examples and intentionally is not exhaustive.

**EXPOSURE DRAFT**

**ED 2021-2**  
(June 2021)

# **Proposed Auditing Standard ASA 101**

## ***Preamble to AUASB 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 31 July 2021. Comments should be addressed to:

The Chairman  
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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## PREFACE

### Reasons for Issuing ED 2021-2

The AUASB issues Exposure Draft ED 2021-2 of proposed Auditing Standard ASA 101 *Preamble to AUASB Standards* (~~Preamble~~) pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is an independent 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.

### Main Proposals

~~The Preamble is the primary interpretive document for AUASB Standards. It sets out the intentions of the AUASB as to how AUASB Standards are to be understood, interpreted and applied.~~

~~AUASB Standards are to be read and applied in conjunction with the Preamble.~~

~~In particular, the Preamble addresses:~~

- ~~(a) — the authority of each paragraph type found within AUASB Standards; and~~
- ~~(b) — the meaning of certain terms included in AUASB Standards.~~

~~The proposed ASA 101 will~~The AUASB is proposing to replace *Auditing Standard* ASA 100 *Preamble to AUASB Standards* issued in 2006 (F2006L01321) and *Auditing Standard* ASA 101 *Preamble to Australian Auditing Standards* issued in 2009 (F2009L04062) with an updated comprehensive Preamble that will apply to all AUASB Standards (Revised ASA 101).

~~ASA 100 was issued in April 2006 as part of the suite of legally enforceable standards issued by the AUASB under the authority given to it through the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9 amendments). To improve the legal enforceability of the Standards issued for the purposes of the CLERP 9 amendments, the AUASB sought legal advice and undertook a process to re-draft standards for legislative purposes. ASA 100 was published to elaborate on the Authority Statements included in the revised standards and set out the intentions of the AUASB, as to how the redrafted AUASB Standards were to be understood, interpreted and applied.~~

~~ASA 100 was repealed from the Federal Register of Legislation in November 2020 but will be preserved on the AUASB website for the purposes of ASRE 2405 *Review of Historical Financial Information Other than a Financial Report*.~~

~~ASA 100 applied to the full suite of standards issued by the AUASB comprising: *Auditing Standards* (ASAs); *Standards on Review Engagements* (ASREs); *Standards on Assurance Engagements* (ASAEs); and *Standards on Related Services* (ASRSs).~~

~~The current ASA 101 applies to all ASAs. ASA 101 was issued in October 2009 in response to the redrafting of the AUASB Standards in clarity format. The “Clarity Project” initiated by the IAASB aimed to enhance the clarity, and thereby the consistent application, of the International Standards on Auditing through a number of fundamental changes, including clarifying obligations imposed by the requirements in standards, setting objectives for each standard and improving the overall readability~~

## **Proposed Auditing Standard ASA 101** ***Preamble to AUASB Standards***

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~~and understandability through restructure and drafting changes. The purpose of ASA 101 in 2009 was to set out mandatory components additional to those found elsewhere in the ASAs.~~

~~Upon its issue in 2009, ASA 101 superseded ASA 100 to the extent that ASA 100 applied to ASAs. The AUASB intended for ASA 100 to remain in force for a period after 1 January 2010 (the operative date for ASA 101) whilst the pre-clarity ASAs remained operative. The Explanatory Memorandum accompanying this proposed Auditing Standard provides an overview of the proposed amendments to the current ASA 101.~~

~~The AUASB is proposing to amend ASA 101 as follows:~~

- ~~(a) — expand its application to cover all AUASB Standards;~~
- ~~(b) — remove requirements included elsewhere in AUASB Standards;~~
- ~~(c) — include additional explanatory material, for example from the repealed ASA 100, which the AUASB considers will improve stakeholder understanding of the key elements of AUASB Standards; and~~
- ~~(d) — make other updates to the Standard to bring its content up to date.~~

### **Proposed Operative Date**

It is intended that this proposed Auditing Standard will be operative for engagements with financial reporting periods commencing on or after 1 October 2021. Early adoption of this Auditing Standard is permitted prior to this date.

### **Main changes from existing ASA 101 *Preamble to Australian Auditing Standards* (October 2009)**

The main differences between this proposed Auditing Standard and the Auditing Standard that it supersedes, ASA 101 *Preamble to Australian Auditing Standards* (October 2009), are included in the Explanatory Memorandum.

## **Request for Comments**

Comments are invited on this Exposure Draft of the proposed re-issuance of ASA 101 no later than 31 July 2021.

The AUASB is seeking comments from stakeholders on the following questions:

1. Do you support the introduction of the proposed revised ASA 101? If not, why not?  
The AUASB prefers that respondents express a clear opinion on whether the proposed Auditing Standard, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on the matters below. The AUASB regards both supportive and critical comments as essential to a balanced review of the proposed Auditing Standard.
2. 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?
3. Are there any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
4. What, if any, are the additional significant costs to/benefits for assurance practitioners and the business community arising from compliance with the main changes to the requirements of this proposed standard? If significant costs are expected, the AUASB would like to understand:
  - a. Where these costs are likely to occur;
  - b. The estimated extent of costs, in percentage terms (relative to fees); and
  - c. Whether expected costs outweigh the benefits to the users of assurance services?
6. Are there any other significant public interest<sup>1</sup> matters that stakeholders wish to raise?

The AUASB asks that comments are sufficiently detailed and include whether stakeholders agree or do not agree with the proposed amendments. The AUASB welcomes any other comments which are not specifically addressed by the questions above.

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<sup>1</sup> The AUASB's Public Interest Framework for the Development of AUASB Pronouncements expands upon what the "public interest" means to the AUASB and provides a useful frame of reference for the AUASB to assess whether its standard-setting process is appropriate and responsive to the public interest. See Appendix 1 of the AUASB's Due Process Framework for Developing, Issuing and Maintaining AUASB Pronouncements and Other Publications.

**AUTHORITY STATEMENT**

Auditing Standard ASA 101 *Preamble to AUASB Standards* is set out in paragraphs 1 to A55.

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 101 *Preamble to AUASB 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).

~~However, W~~here relevant, the AUASB has aligned the wording of this Auditing Standard with the IAASB's *Preface to the International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

# AUDITING STANDARD ASA 101

## *Preamble to AUASB Standards*

### Application

1. This Auditing Standard applies to:
  - (a) an audit of a financial report for a financial year, or an audit or review of a financial report for a half-year, in accordance with the *Corporations Act 2001* (Corporations Act); (Ref: Para. A5-A6; A30-A32)
  - (b) an audit or review of a financial report, or a complete set of financial statements, for any other purpose;
  - (c) an audit or review of other financial information;
  - (d) other assurance engagements;
  - (e) related services engagements; and
  - (f) a firm required to comply with ASQM 1 ~~*Quality Management for Firms that Perform Audits or Reviews of Financial Reports and Other Financial Information, or Other Assurance or Related Services Engagements*~~.<sup>2</sup>

### Operative Date

2. This Auditing Standard is operative for engagements with financial reporting periods commencing on or after 1 October 2021. Early adoption of this Auditing Standard is permitted prior to this date.

### Introduction

#### Scope of this Auditing Standard

3. This Auditing Standard sets out ~~the intentions of the AUASB as to~~ how AUASB Standards are to be understood, interpreted and applied.
4. AUASB Standards are to be read and applied in conjunction with this Auditing Standard. (Ref: Para. A1-A2)

#### Standards issued by the AUASB (Ref: Para. A3-A25)

5. The AUASB derives its functions and powers under section 227B of the *Australian Securities and Investments Commission Act 2001*. The AUASB:
  - (a) makes Auditing Standards under section 336 of the Corporations Act for the purposes of the corporations legislation;<sup>3</sup> and
  - (b) formulates auditing and assurance standards for other purposes.<sup>4</sup>

<sup>2</sup> Or ASQC 1, as applicable. See ASQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Reports and Other Financial Information, or Other Assurance or Related Services Engagements*, issued in March 2021, replaces Auditing Standard ASQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements* from 15 December 2022.

<sup>3</sup> Pursuant to section 227B(1)(a) of the ASIC Act.

<sup>4</sup> Pursuant to section 227B(1)(b) of the ASIC Act.

6. ‘Auditing and assurance standards for other purposes’ consists of standards that are designed for subject-specific areas. They include, for example, assurance engagements that relate to:
- reviews (other than a review by the independent auditor of the entity, of interim financial information, including interim financial reports, prepared for other purposes);
  - evaluating the efficiency and/or effectiveness of an entity’s activities;
  - prospective financial information; and
  - the effectiveness of internal controls.
7. The AUASB issues the following types of standards (AUASB Standards) pursuant to its mandate under section 227B of the ASIC Act:
- (a) Australian Standards on Quality Management (ASQMs);<sup>5</sup>
  - (b) Australian Auditing Standards (ASAs);<sup>6</sup>
  - (c) Standards on Review Engagements (ASREs);<sup>7</sup>
  - (d) Standards on Assurance Engagements (ASAEs); and
  - (e) Standards on Related Services (ASRSs).
8. AUASB Standards do not address **all** the responsibilities of the assurance practitioner<sup>8</sup> that may exist in legislation, regulation or otherwise in connection with engagements that fall within the scope of AUASB Standards. ~~Such responsibilities may differ from those established in AUASB Standards. It is the responsibility of the assurance practitioner to ensure compliance with all relevant legal, regulatory or professional obligations.~~

## Objective

9. The objective of the assurance practitioner is to use this Auditing Standard in order to understand, interpret and apply AUASB Standards.

## Definitions

10. For the purposes of this Auditing Standard, the following terms have the meanings attributed below:
- (a) Assurance practitioner means an individual, firm<sup>9</sup>, or other organisation, whether in public practice, industry and commerce, or the public sector, conducting assurance engagements or related services engagements<sup>10</sup>.
  - (b) AUASB Standards means standards issued by the AUASB, comprising:

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<sup>5</sup> For legislative purposes, ASQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Reports and Other Financial Information, or Other Assurance or Related Services Engagements* and ASQM 2 *Engagement Quality Reviews* are included in legislation as “Auditing Standards” – see paragraph 10(d) of this Preamble.

<sup>6</sup> Defined in paragraph 10(c) of this Preamble.

<sup>7</sup> For legislative purposes, ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity* and ASRE 2415 *Review of a Financial Report: Company Limited by Guarantee or an Entity Reporting under the ACNC Act or Other Applicable Legislation or Regulation*, are included in legislation as “Auditing Standards” – see paragraph 10(d) of this Preamble.

<sup>8</sup> Defined in paragraph 10(a) of this Preamble.

<sup>9</sup> ~~Firm means a sole practitioner, partnership, corporation or other entity of assurance practitioners, or public sector equivalent. The definition of “firm” in relevant ethical requirements may differ from the definition set out in this Auditing Standard.~~

<sup>10</sup> Related services engagements include engagements to perform agreed-upon procedures. The term ‘assurance practitioner’ is referred to in ASRS 4400 *Agreed-Upon Procedures Engagements* as ‘practitioner’.

- (i) Australian Auditing Standards (ASAs) – as defined in paragraph 10(c);
  - (ii) Standards on Review Engagements (ASREs);
  - (iii) Standards on Assurance Engagements (ASAEs); and
  - (iv) Standards on Related Services (ASRSs).
- (c) Australian Auditing Standards (ASAs) means the suite of auditing standards issued by the AUASB, comprising:
- (i) Auditing Standards made under section 336 of the Corporations Act – as defined in paragraph 10(d);
  - (ii) *ASA 805 Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*; and
  - (iii) *ASA 810 Engagements to Report on Summary Financial Statements*.
- (d) Auditing Standards means auditing standards made under section 336 of the Corporations Act, and include:
- (i) ASQM 1;
  - (ii) *ASQM 2 Engagement Quality Reviews*;
  - (iii) *ASRE 2410 Review of a Financial Report Performed by the Independent Auditor of the Entity*; and
  - (iv) *ASRE 2415 Review of a Financial Report: Company Limited by Guarantee or an Entity Reporting under the ACNC Act or Other Applicable Legislation or Regulation*.

~~(e) Firm means a sole practitioner, partnership, corporation or other entity of assurance practitioners, or public sector equivalent.<sup>11</sup>~~

## Requirements

11. The assurance practitioner shall apply AUASB Standards in conjunction with paragraphs 12 and 13 of this Auditing Standard.

### **Authority of the Paragraphs in AUASB Standards** (Ref: Para. A26-A55)

#### **Mandatory Components** (Ref: Para. A28-A44, A55)

12. The assurance practitioner shall apply the mandatory components of AUASB Standards relevant to the engagement. The mandatory components are included in each AUASB Standard under the headings listed below:
- (a) Application ~~(paragraph Aus 0.1)~~. (Ref: Para. A28-A32)
  - (b) Operative Date. (Ref: Para. A33-A35)
  - (c) Objective(s). (Ref: Para. A36)
  - (d) Definition(s). (Ref: Para. A37)

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<sup>11</sup> ~~The definition of “firm” in relevant ethical requirements may differ from the definition set out in this Preamble.~~

**Proposed Auditing Standard ASA 101**  
***Preamble to AUASB Standards***

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- (e) Requirements. (Ref: Para. A38-A44)

**Explanatory Material** (Ref: Para. A45-A55)

13. The assurance practitioner shall have an understanding of the entire text of an AUASB Standard, including its application and other explanatory material, to understand its objectives and to apply the mandatory components of the standard properly. The explanatory material is included in each standard under the headings listed below (where applicable):

- (a) Conformity with International Standards. (Ref: Para. A45-A49)
- (b) Application. (Ref: Para. A28, A32)~~(paragraph Aus 0.2)~~.
- (c) Introduction. (Ref: Para. A50)
- (d) Application and Other Explanatory Material. (Ref: Para. A51-A53)
- (e) Appendices. (Ref: Para. A54)

Explanatory material does not create or extend mandatory components.

## **Application and Other Explanatory Material**

### **Scope of this Auditing Standard** (Ref: Para. 3-4)

#### **“Authority Statement” included in AUASB Standards**

- A1. This Auditing Standard forms an important part of the legal and regulatory framework of AUASB Standards. AUASB Standards are to be read in conjunction with this Auditing Standard.
- A2. All AUASB Standards contain an “Authority Statement”. The purposes of the Authority Statement are to:
- (a) link the issuance of each individual AUASB Standard to the mandating legislation;
  - (b) identify the paragraphs that comprise the AUASB Standard; and
  - (c) set out the requirement to read the AUASB Standard in conjunction with this Auditing Standard.

#### **Standards issued by the AUASB** (Ref: Para. 5-8)

- A3. The AUASB issues the following types of standards pursuant to its mandate under section 227B of the ASIC Act:
- (a) Australian Standards on Quality Management (ASQMs)  
  
ASQMs<sup>12</sup> apply to firms in respect of all engagements to which AUASB Standards apply.  
  
The authority of ASQMs is set out in the introduction to each ASQM.<sup>13</sup>
  - (b) Australian Auditing Standards (ASAs)  
  
ASAs, whilst developed in the context of financial report audits, are to be applied also, as appropriate, to all audits of other historical financial information.  
  
The authority of the suite of ASAs is set out in ASA 200<sup>14</sup>. ASA 200 deals with the auditor’s overall responsibilities when conducting an audit of a financial report in accordance with ASAs. Specifically, it sets out the overall objectives of the auditor, and explains the nature and scope of an audit designed to enable the auditor to meet those objectives. It also explains the scope, authority and structure of the ASAs, and includes requirements establishing the general responsibilities of the auditor applicable in all audits, including the obligation to comply with the ASAs.  
  
The ASAs, taken together, provide the standards for the auditor’s work in fulfilling the overall objectives of the auditor. The ASAs deal with the general responsibilities of the auditor, as well as the auditor’s further considerations relevant to the application of those responsibilities to specific topics.

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<sup>12</sup> For legislative purposes, ASQM 1 and ASQM 2 are included in legislation as “Auditing Standards”.

<sup>13</sup> See ASQM 1, paragraph 12, and ASQM 2, paragraph 10, under the heading “Authority of this ASQM”.

<sup>14</sup> See ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

(c) Standards on Review Engagements (ASREs)

ASREs<sup>15</sup> are to be applied to the review of a financial report and the review of other historical financial information.

The authority of ASREs is set out in the introduction to each ASRE.<sup>16</sup>

(d) Standards on Assurance Engagements (ASAEs)

ASAEs are to be applied to assurance engagements dealing with subject matters other than historical financial information.<sup>17</sup>

ASAE 3000<sup>18</sup> explains the scope, authority and structure of the ASAEs, and includes requirements regarding the conduct of an assurance engagement in accordance with ASAEs.<sup>19</sup>

Where a subject-matter specific ASAE is relevant to the subject matter of a particular engagement, that ASAE applies in addition to ASAE 3000. The introduction to each subject-matter specific ASAE sets out the relationship of the ASAE with ASAE 3000.

(e) Standards on Related Services (ASRSs)

ASRSs are to be applied when an assurance practitioner is engaged to undertake engagements other than assurance engagements covered by ASAs, ASREs or ASAEs.<sup>20</sup>

The authority of ASRSs is set out in the introduction to each ASRS.<sup>21</sup>

A4. The scope, operative date and any specific limitation of the applicability of a specific AUASB Standard, is made clear in each standard.

**Auditing Standards made under Section 336 of the Corporations Act**

A5. Auditing Standards made under section 336 of the Corporations Act apply to:

- (a) an audit of a financial report for a financial year, or an audit or review<sup>22</sup> of a financial report for a half-year, prepared in accordance with Part 2M.3 of the Act;
- (b) an audit conducted under Part 7.8 of the Act;
- (c) an audit of a financial report, or a complete set of financial statements, prepared for any other purpose;

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<sup>15</sup> For legislative purposes, ASRE 2410 and ASRE 2415 are included in legislation as “Auditing Standards”:

<sup>16</sup> For example, see ASRE 2400 *Review of a financial Report Performed by an Assurance Practitioner Who is Not the Auditor of the Entity*, paragraphs 9-12.

<sup>17</sup> Examples of such subject matters include the efficiency and/or effectiveness of an entity’s activities, prospective financial information and the effectiveness of internal controls. The AUASB’s *Framework for Assurance Engagements*, which defines and describes the elements and objectives of an assurance engagement, provides the context for understanding ASAEs.

<sup>18</sup> See ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.

<sup>19</sup> See ASAE 3000, “Introduction” (paragraphs 1-8) and “Conduct of an Assurance Engagement in Accordance with ASAEs” (paragraphs 14-20).

<sup>20</sup> Examples of financial and non-financial subject matters on which Standards on Related Services may be applied include: Agreeing the eligibility of expenditures claimed from a funding program; Recalculating revenues for determining royalties, rent or franchise fees based on a percentage of revenues; Confirming the calculation of capital adequacy ratios for regulatory authorities; Observation of the destruction of fake or defective goods reported to a regulatory authority; and Tracing data generating processes for lottery draws reported to a regulatory authority.

<sup>21</sup> For example, see ASRS 4400, paragraphs 7-10. Where this information is not included in the introduction of an ASRS, for example ASRS 4450 *Comfort Letter Engagements*, relevant terms are to be interpreted in a directly analogous way to how they are explained in the context of ASRS 4400.

<sup>22</sup> For legislative purposes, ASRE 2410 and ASRE 2415 are included in legislation as “Auditing Standards”.

- (d) a review, by the independent auditor of the entity, of a financial report, or a complete set of financial statements, comprising historical financial information, for any other purpose; and
- (e) a firm required to comply with ASQM 1.
- A6. Although ~~the~~ Auditing Standards are written mainly in the context of an external audit of a financial report,<sup>23</sup> they apply also, adapted as necessary, to the audit of other historical financial information.

### **Compliance and Enforcement**

- A7. ~~The extent of compliance required with AUASB Standards is determined by the legislative or regulatory requirements of relevant industry regulators, and/or an entity's constitution or other governing documents, in conjunction with the application paragraphs of the standards~~ AUASB Standards are not legally binding in all contexts:
- Standards made and issued under section 336 of the Corporations Act for the purposes of the corporations legislation have ~~legal~~ status ~~of law and must be complied with under the Act.~~<sup>24</sup> ~~These standards are classified as disallowable legislative instruments under the Legislation Act 2003.~~<sup>25</sup> ~~Where engagements covered by these standards are undertaken for the purposes of complying with the Corporations Act, full compliance is required as a matter of law.~~<sup>26</sup>
  - Auditing and assurance standards may also be issued ~~or used~~ for other purposes. ~~These standards do not have legal effect under the Corporations Act itself but may be legally enforceable under other legislation or authority.~~ Where auditing and assurance standards are used for purposes other than complying with the Corporations Act, ~~compliance with those standards may not be required as a matter of law. There are, however, circumstances in which compliance is required by other legislation, regulatory or contractual arrangements.~~
- A8. Auditing Standards issued by the AUASB under the Corporations Act, are legally enforceable by the Australian regulator – the Australian Securities and Investments Commission (ASIC). ASIC conducts regular inspection programmes as an integral part of its enforcement responsibilities.
- A9. Through the standards issued by the Accounting Professional & Ethical Standards Board (APESB), members of the Australian Professional Accounting Bodies are compelled to comply with the requirements of AUASB Standards.<sup>27</sup>
- A10. Member compliance is enforced through the inspection programmes of the Professional Accounting Bodies, which are also responsible for member disciplinary action.

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<sup>23</sup> Reference to a 'financial report' includes not only a financial report as defined under Part 2M.3 of the Act, but also a financial report prepared for other purposes. Financial reports required by Part 2M.3 of the Corporations Act are:

- the annual financial report; and
- the half-year financial report (for certain entities).

<sup>24</sup> ~~These standards are classified as disallowable legislative instruments under the Legislation Act 2003. The AUASB has adopted certain drafting principles in making Auditing Standards under the Australian regulatory environment, wherein the Auditing Standards are legally enforceable and registered as legislative instruments under the Legislation Act 2003, Section 307A of the Corporations Act requires auditors to conduct audits and reviews of financial reports prepared under Part 2M.3 of the Act, in accordance with Auditing Standards.~~

<sup>25</sup> ~~Section 307A of the Corporations Act requires auditors to conduct audits and reviews of financial reports prepared under Part 2M.3 of the Act, in accordance with Auditing Standards. The AUASB has adopted certain drafting principles in making Auditing Standards under the Australian regulatory environment, wherein the Auditing Standards are legally enforceable and registered as legislative instruments under the Legislation Act 2003.~~

<sup>26</sup> ~~Section 307A of the Corporations Act requires auditors to conduct audits and reviews of financial reports prepared under Part 2M.3 of the Act in accordance with Auditing Standards.~~

<sup>27</sup> See APES 210 *Conformity with Auditing and Assurance Standards*, issued by the APESB.

### **Type of Entity**

A11. AUASB Standards are:

- (a) neutral with respect to the sector and size of the entity subject to the engagement; and
- (b) intended to be applied, as appropriate, to all audit, review, assurance and related service engagements conducted by an external firm in both the public and private sectors.

A12. The AUASB generally does not set industry or sector specific standards but may from time to time produce industry or sector specific guidance materials. ~~However, w~~Where necessary, entity sector and size considerations are included, and identified, in the body of the relevant AUASB Standard.

A13. AUASB Standards do not take into account any specific circumstances affecting entities that are subject to the engagement.

### *Public Sector Engagements*

A14. AUASB Standards are relevant to engagements in the public sector. When appropriate, additional considerations specific to public sector entities are included within the ~~“a~~Application and e~~Other e~~Explanatory m~~Material”~~ section of each standard.

A15. The responsibilities of public sector assurance practitioners may be affected by the ~~engagement’s~~ mandate applying to the engagement, or by obligations on public sector entities arising from law, regulation or other authority (such as ministerial directives, government policy requirements, or resolutions of the legislature), which may encompass a broader scope than an engagement in accordance with the AUASB Standards. These additional responsibilities are not dealt with in the AUASB Standards. They may be dealt with in guidance developed by government audit agencies<sup>28</sup>.

### **Applying AUASB Standards**

#### *Professional Judgement*

A16. Professional judgement is essential to the proper conduct of engagements that fall within the scope of AUASB Standards. This is because interpretation of relevant ethical requirements and relevant AUASB Standards and the informed decisions required throughout the engagement cannot be made without the application of relevant training, knowledge and experience to the facts and circumstances.<sup>29</sup>

#### *Professional Scepticism*

~~A17. Auditing and assurance standards require an assurance practitioner to adopt an attitude of professional scepticism in applying the relevant AUASB Standards to an engagement. For further information, refer to *Framework for Assurance Engagements*.<sup>30</sup>~~

### **Ethical Principles and Quality Management Standards**

~~A18.~~A17. Compliance with ethical principles, including independence requirements, and quality management within firms that perform engagements to which AUASB Standards apply, ~~and~~

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<sup>28</sup> In Australia the term “government audit agencies” refers to State, Territory or Commonwealth Auditors-General.

<sup>29</sup> The term “professional judgement” is defined in the AUASB Glossary in the context of different types of AUASB Standards. For assurance engagements, see *Framework for Assurance Engagements*, paragraphs 56-60. For related services engagements, see ASRE 4400, paragraphs 13(j) and 18.

<sup>30</sup> The term ‘professional scepticism’ is defined in the AUASB Glossary in the context of different types of AUASB Standards. Also, see *Framework for Assurance Engagements*, paragraphs 51-55.

~~compliance with ethical principles, including independence requirements,~~ are widely recognised as being in the public interest and an integral part of a high-quality engagement.<sup>31</sup>

#### *Relevant Ethical Requirements*

~~A19.~~A18. References to compliance with relevant ethical requirements are included in certain requirements and explanatory material paragraphs in AUASB Standards. AUASB Standards are to be read in conjunction with relevant ethical requirements, as defined in ASA 102.<sup>32</sup> Law, regulation or relevant ethical requirements may establish responsibilities for the assurance practitioner beyond those described in AUASB Standards.

#### *Quality Management Standards*

~~A20.~~A19. ASQM 1 deals with a firm's responsibilities to design, implement and operate a system of quality management for audits or reviews of financial statements, or other assurance or related services engagements.

~~A21.~~A20. Engagement quality reviews form part of the firm's system of quality management and:

- (a) ASQM 1 deals with the firm's responsibility to establish policies or procedures addressing engagements that are required to be subject to engagement quality reviews.
- (b) ASQM 2 deals with the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review.

~~A22.~~A21. AUASB Standards are premised on the basis that a firm is subject to the ASQMs, and include requirements regarding quality management at the engagement level.<sup>33</sup>

#### **Amendments to AUASB Standards**

~~A23.~~A22. AUASB Standards may require amendment for a variety of reasons, such as consequential and conforming amendments that is required as a result of changes made to other AUASB Standards.

#### *Consequential and Conforming Amendments*

~~A24.~~A23. As standards made under section 336 of the Corporations Act are legislative instruments, they can only be amended by another legislative instrument. An "Amending Standard" is a legislative instrument made by the AUASB for the sole purpose of amending other legislative instruments (referred to as the "principal standard"). Amending Standards provide an efficient way of processing amendments which affect a number of standards without reissuing all the standards affected.

#### *Compilations*

~~A25.~~A24. ~~Compilations~~ The compiled version of a standard reflects the content of a standard, considering all amendments that have become effective since the principal standard was originally made. Compilations are a requirement of the *Legislation Act, 2003* and are required to be lodged with the Office of Parliamentary Counsel for registration on the Federal Register of Legislation. A compilation is not a legislative instrument.<sup>34</sup>

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<sup>31</sup> For further details, refer to *Framework for Assurance Engagements*, paragraphs 5-9.

<sup>32</sup> See ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements*.

<sup>33</sup> For example, see ASA 220 *Quality Management for an Audit of Financial Statements*.

<sup>34</sup> For example, a standard might have a principal version issued in 2015 amended by Amending Standards (legislative instruments) that become effective, one each year, from 2016. Therefore, in 2020 the compiled version of the standard will reflect the amendments effective from 2016 through to 2020.

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**Preamble to AUASB Standards**

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A26-A25. Where the AUASB issues a compiled version of a standard:

- (a) the title page of the standard indicates that it is a compiled version of the standard and shows the date of the compilation and the relevant Amending Standards that have been taken into account;
- (b) a “Compilation Details” section is included in the standard which includes the following information:
  - (i) a “Table of Standards”, which sets out details of both the principal standard and subsequent Amending Standards, including the dates of both the principal and Amending Standards (date made, operative date and date registered on the Federal Register of Legislation);
  - (ii) a “Table of Amendments”, which provides details of amendments to the principal standard (paragraph of standard affected, how affected and a paragraph reference to the relevant Amending Standard); and
  - (iii) a statement that the compilation is not a separate Auditing Standard made by the AUASB but a representation of the relevant Standard which incorporates the original standard and subsequent amendments.
- (c) the Operative Date paragraph in the standard includes a reference to the Compilations Details section of the standard, for details about the operative dates of paragraphs changed or added by an Amending Standard. (Ref: Para. A33(a))

**Authority of the Paragraphs in AUASB Standards** (Ref: Para. 12-13)

A27-A26. The paragraphs in AUASB Standards do not have equal authority. AUASB Standards consist of paragraphs that are either:

- (a) mandatory components; or
- (b) explanatory material.

A28-A27. Where an AUASB Standard does not include specific information to explain the status and authority of the paragraphs included within the standard, the terms explained below (for example, “Objectives”, “Requirements”, “Application and Other Explanatory Material”), are to be interpreted in a directly analogous way to how they are explained in the context of financial report audits in ASA 200.

**Mandatory Components** (Ref: Para. 12)

“Application” Paragraphs (Ref: Para. 12(a), 13(b))

A29-A28. Each AUASB Standard contains a mandatory “Application” paragraphs that, in part or in whole, form part of the mandatory components of a standard. The standard may also include an additional “Application” paragraph that forms part of the explanatory material of the standard, to describe other engagements the standard may be applied to, adapted as necessary.

A30-A29. The “Application” paragraph or paragraphs of a standard identify the scope of the AUASB Standard.

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Engagements under the Corporations Act (Ref: Para. 1(a); A5-A6)

~~A31.A30.~~ Auditing Standards made under section 336 of the Corporations Act<sup>35</sup> contain a mandatory ~~“aApplication”~~ paragraphs (shown as paragraph “Aus 0.1”) relating 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; and
- (b) an audit of a financial report, or a complete set of financial statements, for any other purpose.

~~A32.A31.~~ The “Application” paragraph in each Auditing Standard that refers to audits or reviews conducted in accordance with the Corporations Act applies specifically to:

- (d) an audit or a review conducted under Part 2M.3 of the Act; and
- (e) an audit conducted under Part 7.8 of the Act.

~~A33.A32.~~ ~~When an Auditing Standard is used for the audit of financial information that is not in the form of a financial report, the application paragraph in that Auditing Standard is excluded from the mandatory components. Auditing Standards may also include an additional “Application” paragraph (shown as paragraph “Aus 0.2”) that forms part of the explanatory material of the standard to explain that, although the Auditing Standards are written mainly in the context of an audit of a financial report, they apply also, adapted as necessary, to the audit of other historical financial information.~~

*Operative Date* (Ref: Para. 12(b))

~~A34.A33.~~ The operative date stipulates the date from which the AUASB Standard is to be applied. The operative date is stated in relation to a financial reporting period. The requirements of an AUASB Standard remain in force until:

- (a) the operative date of any amendment to those requirements (Ref: Para. A22-A25));
- (b) in relevant circumstances, the early adoption of such amendments; or
- (c) the AUASB Standard is withdrawn by the AUASB.

~~A35.A34.~~ Unless otherwise stated in an AUASB Standard, the assurance practitioner is permitted to apply a standard before the operative date specified therein. Where an AUASB Standard is early adopted, all relevant conforming and consequential amendments must also be early adopted.

~~A36.A35.~~ Where an assurance practitioner is conducting an audit of a financial report and elects to early adopt an auditing standard made under section 336 of the Corporations Act, in accordance with section 336(4), that election must be recorded in the audit report.

*Objective(s)* (Ref: Para. 12(c))

~~A37.A36.~~ Each AUASB Standard contains an objective or objectives which provide the context in which the requirements of the standard are set and, establishes the desired outcome to be achieved by the assurance practitioner. The proper application of the requirements in the standard is expected to provide a sufficient basis for the practitioner’s achievement of the objective(s) of the standard and is intended to assist the assurance practitioner in understanding what needs to be accomplished and, where necessary, the appropriate means of doing so.

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<sup>35</sup> With the exception of ASA 101, ASA 102, ASQM 1, ASQM 2, ASRE 2410 and ASRE 2415.

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*Definitions* (Ref: Para. 12(d))

~~A38.~~A37. Definitions, contained within AUASB Standards, and/or contained within the *AUASB Glossary* (as issued from time to time), provide a description of the meanings attributed to certain terms for the purposes of the AUASB Standards. These definitions are provided ~~to assist in for the~~ consistent application and interpretation of standards, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. The *AUASB Glossary* contains a complete listing of terms defined in AUASB Standards.

*Requirements* (Ref: Para. 12(e))

~~A39.~~A38. Paragraphs that impose obligations on the assurance practitioner ~~The requirements of each AUASB Standard~~ are contained in a separate “Requirements” section of each standard and expressed using the word “shall”. Requirements are designed to enable the assurance practitioner to meet the stated objective(s) of an AUASB Standard. In certain circumstances, requirements are legally binding and enforceable.

~~A40.~~A39. The assurance practitioner applies the requirements in the context of the other material included in the AUASB Standard (for example, introductory material, definitions and application and other explanatory material). The entire text of an AUASB Standard, therefore, is relevant to an understanding of the objectives stated in an AUASB Standard and the proper application of the requirements of the ~~AUASB Standard~~. Although the assurance practitioner has a responsibility to consider the entire text of the standard in carrying out the engagement, application and explanatory material does not in itself impose a requirement.

~~A41.~~A40. For information on how the requirements in AUASB Standards are to be applied for:

- (a) audits and reviews of historical financial reports and information – see ASA 200;<sup>36</sup>
- (b) assurance engagements other than audits or reviews of historical financial information – see ASAE 3000.<sup>37</sup>

These standards also include requirements and explanatory material on the limited circumstances where the assurance practitioner may judge it necessary to depart from a relevant requirement in a standard. ~~The need for the assurance practitioner to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective in achieving the aim of the requirement.~~

A41. The assurance practitioner is required to comply with all AUASB Standards relevant to an engagement. Furthermore, AUASB Standards require compliance with each requirement of a relevant standard unless, in the circumstances of the engagement, the requirement is not relevant because it is conditional and the condition does not exist.<sup>38</sup>

A42. When, in the circumstances of an engagement:

- (a) an entire AUASB Standard is not relevant; or
  - (b) a requirement is not relevant because it is conditional and the condition does not exist,
- there is no requirement to document the reason(s) why the requirement is not relevant.<sup>39</sup>

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<sup>36</sup> See ASA 200, paragraphs 18-24.

<sup>37</sup> See ASAE 3000, paragraphs 14-19.

<sup>38</sup> See ASA 200, paragraph 22 and ASAE 3000, paragraph 17.

<sup>39</sup> See ASA 230 *Audit Documentation*, paragraph A19, which explains that the requirement to document an inability to comply with relevant requirements, applies only to requirements that are relevant in the circumstances.

**Proposed Auditing Standard ASA 101**  
**Preamble to AUASB Standards**

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- A43. However, for audits or reviews conducted in accordance with the Corporations Act, where in rare and exceptional circumstances, factors outside the assurance practitioner's control prevent the practitioner from complying with an essential procedure contained within a relevant requirement, the practitioner is required under ASA ~~200-230~~<sup>40</sup> or ASRE 2410<sup>41</sup>, as applicable, to document:
- (a) the circumstances surrounding the inability to comply;
  - (b) the reasons for the inability to comply; and
  - (c) justification of how alternative procedures achieve the objectives of the requirement.
- A44. In the case of a review and related services engagement, the assurance practitioner is required to apply the requirements contained only in the specified standard applicable to that engagement, in conjunction with this Preamble to AUASB Standards. There is no requirement to apply the requirements of other AUASB Standards. However, reference to ASAs may be helpful to provide guidance.

**Explanatory Material** (Ref: Para. 13)

*Conformity with International Standards* (Ref: Para. 13(a))

- A45. The Conformity paragraphs explain the relationship of an AUASB Standard with its equivalent international standard issued by the IAASB. ~~The AUASB takes the position that an~~<sup>An</sup> AUASB Standard conforms to the equivalent international standard when:
- (a) the requirements of the AUASB Standard correspond with those in the equivalent international standard or the AUASB Standard contains additional requirements; and
  - (b) the explanatory material is substantially the same as the equivalent international standard or the AUASB Standard contains additional explanatory material.
- A46. The Conformity paragraphs in AUASB Standards include necessary differences from the equivalent international standard relating to terminology, referencing and Australian regulatory requirements.<sup>42</sup>
- A47. When an AUASB Standard and the equivalent international standard conform, the Conformity paragraphs contain a statement to this effect.
- A48. When an AUASB Standard and the equivalent international standard are not equivalent, the Conformity paragraphs detail the main differences.
- A49. The Conformity paragraphs in each AUASB Standard assist the assurance practitioner to determine to what extent (if any) compliance with AUASB Standards might enable also the engagement to be conducted in compliance with international standards. It is the responsibility of the assurance practitioner to determine which standards apply to the particular engagement and circumstances. Furthermore, where appropriate, the Conformity paragraphs contain the following sentence:

“Compliance with this Standard enables compliance with the equivalent international standard”.

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<sup>40</sup> See *ASA 230 Audit Documentation*, paragraph Aus 12.1.

<sup>41</sup> See ~~ASA 200, paragraph Aus 23.1~~ and ASRE 2410, paragraph 7.

<sup>42</sup> Refer to the *AUASB Policy and Process for International Conformance and Harmonisation of Standards* for details of the principles and process the AUASB applies in considering modifications to IAASB Standards.

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**Preamble to AUASB Standards**

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*Introduction* (Ref: Para. 13(c))

- A50. Introductory material provides context relevant to a proper understanding of an AUASB Standard. Introductory material may include, as needed, such matters as explanation of the:
- purpose and scope of the Standard, including how the Standard relates to other AUASB Standards;
  - subject matter of the Standard; and
  - respective responsibilities of the assurance practitioner and others in relation to the subject matter of the Standard.

*Application and Other Explanatory Material* (Ref: Para. 13(d))

- A51. Included within the requirements section of a standard are references to paragraphs in the “aApplication and eOther eExplanatory mMaterial” section of the standard. Such references do not extend or create requirements.
- A52. Where necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying the requirements out. In particular, it may:
- explain more precisely what a requirement means or is intended to cover; and
  - include examples that illustrate how the requirements might be applied and/or provide examples of procedures that may be appropriate in the circumstances.

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 an AUASB Standard.

- A53. Where appropriate, additional considerations specific to public sector and smaller entity engagements are included within the “aApplication and eOther eExplanatory mMaterial” section of the standard. These additional considerations assist in the application of the requirements of the standards in conducting such engagements. However, Tthey do not, however, limit or reduce the responsibility of the assurance practitioner to apply and comply with the requirements of AUASB Standards.

*Appendices* (Ref: Para. 13(e))

- A54. Appendices, ~~which~~ form part of the application and other explanatory material, ~~are an integral part of a standard~~. The purpose and intended use of an appendix are explained in the body of the related standard or within the title and introduction of the appendix itself.

*AUASB Drafting Conventions* (Ref: Para. 12-13)

- A55. The following drafting principles and conventions apply to AUASB Standards:
- (a) The requirements of each AUASB Standard are contained in a separate “Requirements” section of a standard. The requirements of an AUASB Standard are expressed using the word “shall” to denote the obligations an assurance practitioner is required to comply with in achieving the objective or objectives stated in the standard, and expressed using the word “shall”. The requirements paragraphs support the objectives of the standard;
  - (b) Paragraphs containing application and other explanatory material are designated with the letter “A”.
  - (c) The present tense of verbs is used in explanatory material when it is the best form of expression. Use of the present tense does not create or imply requirements. The

**Proposed Auditing Standard ASA 101**  
***Preamble to AUASB Standards***

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present tense is used in examples and other explanatory material that relate to professional judgement and professional scepticism.

- (d) Requirements that exist in another AUASB Standard are anchored back to the original requirement (for example, using the phrase “in accordance with”) when repetition or a cross reference is considered necessary for understanding and context.
- (e) Australian additions or modifications to an equivalent IAASB Standard are marked as Australian paragraphs or additional appendices commencing with an “Aus” prefix.
- (f) Deletions from an equivalent IAASB Standard are clearly noted as “Deleted by the AUASB. Refer Aus ...”.
- (g) The extent of differences between an AUASB Standard and its equivalent international standard are detailed in the “Conformity with International Standards” section of the standard.
- (h) The word “including”, as used in AUASB Standards, means a list of items or examples is provided but the list does not purport to contain all relevant items or examples and intentionally is not exhaustive.

~~A56. Appendix 1 provides a summary of words and phrases commonly used in AUASB Standards.~~

## Appendix 1

(Ref: Para. A57)

### Words and Phrases commonly used in AUASB Standards

The following words and phrases are used in AUASB Standards for the respective stated purposes (alphabetically):

- (a) ~~*explanatory guidance* means suggested or typical audit procedures, practical examples and other explanatory details and procedures that are included for the purposes of understanding, and complying with, mandatory requirements. Explanatory guidance does not create or extend mandatory requirements or the auditor's obligations under AUASB Standards.~~
- (b) ~~*'in accordance with...the assurance practitioner is required to...'* means explanatory material guidance that is directly linked to a mandatory requirement, either in the same AUASB Standard or in another AUASB Standard. The phrase is used only where the wording in the explanatory material guidance is identical to that in the mandatory requirement.~~
- (c) ~~*including* means a list of items or examples is provided but the list does not purport to contain all relevant items or examples and intentionally is not exhaustive.~~
- (d) ~~*mandatory requirements* means relevant basic principles and essential procedures that must be applied in order for the audit or review engagement to comply with AUASB Standards.~~
- (e) ~~*ordinarily* means the explanatory material guidance indicates practical methods or means by which mandatory requirements may be complied with and is to be read in the following context:~~
- (i) ~~where the word 'ordinarily' is used, the assurance practitioner exercises professional judgement in considering:~~
- ~~• whether the noted circumstances apply to the current audit, review or other assurance engagement; and~~
  - ~~• if so, whether the suggested procedures are appropriate to perform; or~~
  - ~~• where there are alternative procedures which are more appropriate, whether these alternative procedures are to be performed.~~
- (ii) ~~the word 'ordinarily' does not create a rebuttable presumption nor a mandatory requirement.~~
- (f) ~~*shall* means an imperative obligation on assurance practitioners when appearing in **bold-type** mandatory requirements. In certain circumstances, imperative obligations are legally binding and enforceable.~~
- (g) ~~*'Under...the assurance practitioner needs to...'* means words contained within the explanatory guidance material that highlight a linkage between mandatory requirements and the relevant explanatory material guidance that:~~
- (i) ~~in part, or in whole, restates the meaning of the mandatory requirement; and~~

~~(ii) — may describe audit or review procedures, more detailed than those contained in the relevant mandatory requirement. However, these described audit or review procedures do not create or extend mandatory requirements.~~

~~Furthermore, an assurance practitioner may judge it necessary, in order to comply with the relevant mandatory requirement, to:~~

- ~~• — perform alternative audit or review procedures in place of some or all of those described in the explanatory material guidance; or~~
- ~~• — perform some, but not all, of the audit or review procedures described in the explanatory material guidance.~~

~~The purpose of the linkage between the mandatory requirements and the relevant explanatory material guidance is to:~~

- ~~• — direct the assurance practitioner to the relevant mandatory requirement(s); and~~
- ~~• — emphasise that interpretation of the explanatory material guidance is to be made in the context of that mandatory requirement.~~
- ~~• —~~



# **Explanatory Memorandum**

## **Exposure Draft 02/21**

### ***Proposed Auditing Standard ASA 101 Preamble to AUASB Standards***

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



## **Obtaining a Copy of this Explanatory Memorandum**

This Explanatory Memorandum is available on the Auditing and Assurance Standards Board (AUASB) website: [www.auasb.gov.au](http://www.auasb.gov.au)

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**Explanatory Memorandum**  
**Exposure Draft 02/21: *Proposed Auditing Standard ASA 101 Preamble to AUASB Standards***

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*Important Note and Disclaimer*

This Explanatory Memorandum is issued by the AUASB to provide information to assurance practitioners about the AUASB's proposed Auditing Standard ASA 101 *Preamble to AUASB Standards*, which will replace ASA 100 *Preamble to AUASB Standards* issued in 2006 (F2006L01321) and ASA 101 *Preamble to Australian Auditing Standards* issued in 2009 (F2009L01321).

This Explanatory Memorandum does not establish or extend the requirements under existing AUASB Standards and is not intended to be a substitute for compliance with the relevant AUASB Standards with which auditors and assurance practitioners are required to comply with when conducting an audit or other assurance engagement. No responsibility is taken for the results of actions or omissions to act on the basis of any information contained in this document or for any errors or omissions in it.

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## **EXPLANATORY MEMORANDUM**

### **Exposure Draft 02/21: *Proposed Auditing Standard ASA 101 Preamble to AUASB Standards***

#### **Purpose**

1. The aim of this Explanatory Memorandum is to:
  - (a) provide stakeholders with information about Exposure Draft 02/21: *Proposed Auditing Standard ASA 101 Preamble to AUASB Standards* (ED 02/21), issued in June 2021; and
  - (b) seek stakeholder feedback on the Exposure Draft.

#### **Background**

2. The AUASB currently has two preambles to its standards:
  - (a) *ASA 100 Preamble to AUASB Standards*

Upon its issuance in 2006, ASA 100 applied to the full suite of standards issued by the AUASB comprising: Australian Auditing Standards (ASAs); Standards on Review Engagements (ASREs); Standards on Assurance Engagements (ASAEs); and Standards on Related Services (ASRSs).
  - (b) *ASA 101 Preamble to Australian Auditing Standards*

Upon its issuance in 2009, ASA 101 superseded ASA 100 to the extent that ASA 100 applied to ASAs.
3. ASA 100 and ASA 101 together serve as the primary interpretive documents for AUASB Standards. These standards set out how AUASB Standards are to be understood, interpreted and applied. AUASB Standards are to be read and applied in conjunction with the AUASB's two preambles.
4. In May 2020, the AUASB approved a project plan to update the AUASB's due process framework, and related policies and framework pronouncements. The AUASB's preambles were specifically identified in the plan for review and updating.
5. In September 2020, the AUASB supported a proposal to replace ASA 100 and ASA 101 with a single comprehensive preamble that will apply to all AUASB Standards; that is, to:
  - (a) expand the scope of ASA 101 to also include standards other than ASAs; and
  - (b) amend ASA 101 to improve stakeholder understanding of the key components of AUASB Standards.
6. The proposed revisions to ASA 101 have been made with the public interest at the forefront, including stakeholder useability and understanding of the AUASB Standards.
7. The proposed revised ASA 101 includes references to the new suite of Quality Management Standards, ASQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Reports and Other Financial Information, or Other Assurance or Related Services Engagements* and ASQM 2 *Engagement Quality Reviews*, which were approved and issued by the AUASB in March 2021. ASQM 1 and ASQM 2 will replace the current ASQC 1 *Auditing Standard ASQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements* from 15 December 2022.

*ASA 100*

8. ASA 100 was issued in April 2006 as part of the suite of legally enforceable standards issued by the AUASB under the authority given to it through the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9). To improve the legal enforceability of the standards issued for the purposes of the CLERP 9 amendments, the AUASB sought legal advice and undertook a process to re-draft standards made by the former Auditing & Assurance Standards Board of the Australian Accounting Research Foundation (AARF) to make them legally enforceable under the *Corporations Act 2001* (Corporations Act). The types of changes made to the standards included replacing the term “should” with “shall” and the inclusion of material for legislative purposes such as an “Authority Statement” which provided a mechanism to delineate between mandatory requirements and explanatory guidance within a standard. Mandatory components of AUASB Standards were identified by **bold-type** - the “pre-clarity” format of present AUASB Standards. With the exception of ASRE 2405 *Review of Historical Financial Information Other than a Financial Report*, no AUASB Standard on issue is in pre-clarity format.
9. ASA 100 was published to elaborate on the Authority Statements included in the revised standards and set out the intentions of the AUASB as to how the redrafted AUASB Standards were to be understood, interpreted and applied.

*ASA 101*

10. ASA 101 was issued in October 2009 in response to the redrafting of the AUASB Standards in “clarity” format. The “Clarity Project” initiated by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting Board of the International Federation of Accountants (IFAC), aimed to enhance the clarity, and thereby the consistent application, of the International Standards on Auditing through a number of fundamental changes, including clarifying obligations imposed by the requirements in standards, setting objectives for each standard and improving the overall readability and understandability through restructure and drafting changes. As the (revised) Australian Auditing Standards were legally enforceable, the AUASB considered it necessary for an interpretive document to form part of the suite of standards.
11. The purpose of ASA 101 in 2009 was to set out mandatory components additional to those included elsewhere in the Australian Auditing Standards<sup>1</sup>. The “Requirements” section of extant ASA 101:
  - (a) Sets out the authority of paragraphs in ASAs. The mandatory components of the ASAs are those included under the headings: “Application”, “Operative Date”, “Objective(s)”, “Definition(s)” and “Requirements”.
  - (b) Identifies the parts of the Corporations Act to which the “Application” paragraph in each Auditing Standard that refers to audits or reviews conducted in accordance with the Corporations Act applies; and
  - (c) Describes the circumstances when an auditor is not required to document the reasons why a requirement is not relevant.
12. Upon its issuance in 2009, ASA 101 superseded ASA 100 to the extent that ASA 100 applied to ASAs; ASA 101 did not fully supersede ASA 100 for other pronouncements.
13. The AUASB intended for ASA 100 to remain in force for a period after 1 January 2010 (the operative date for ASA 101) whilst the pre-clarity ASAs remained operative.

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<sup>1</sup> See ASA 101, paragraph 5.

14. ASA 100 was repealed from the Federal Register of Legislation in November 2020 but will be preserved on the AUASB website as it still applies to ASRE 2405 *Review of Historical Financial Information Other than a Financial Report* (a non ‘Force of Law’ standard).

### **Key proposals contained in ED 02/21**

15. The objectives of the key proposals contained in ED 02/21 are to:

- (a) expand the scope of ASA 101 to apply to all AUASB Standards; and
- (b) amend ASA 101 to include additional interpretive guidance, for example from the repealed ASA 100, to improve stakeholder understanding of the key components of AUASB Standards.

16. The changes proposed in ED 02/21 are:

(a) **Expand the scope of ASA 101 to apply to all AUASB Standards.**

- ASA 101 currently applies only to ASAs, including ASQMs and ASREs issued as “Auditing Standards” under the Corporations Act. ASA 100 applies to all AUASB Standards other than the ASAs<sup>2</sup> (explained in paragraphs 2-14 above).
- ED 02/21 expands the scope of extant ASA 101 to apply to all AUASB Standards (see ED 02/21, paragraph 1).
- As ED 02/21 will apply to all AUASB Standards, the term “auditor” has been replaced with “assurance practitioner” throughout the proposed revised standard. ED 02/21 includes a definition of “assurance practitioner” in paragraph 10(a), which mirrors the definition used in ASQM 1<sup>3</sup>, paragraph Aus 16.2.

(b) **Clarify that the purpose of the proposed revised ASA 101 is to improve the clarity of all AUASB Standards by providing interpretative guidance applicable to all AUASB Standards**

- ED 02/21 is being proposed in order to consolidate ASA 100 and ASA 101 into a single comprehensive Preamble that will provide interpretive guidance applicable to all AUASB Standards.
- It therefore follows that the scope and purpose of the proposed revised ASA 101 will differ from that of extant ASA 101 that it will supersede.
  - The scope of extant ASA 101 includes setting out mandatory components additional to those included elsewhere in the Australian Auditing Standards.<sup>4</sup>
  - In contrast, the scope of ED 02/21 is limited to providing interpretive guidance as to how AUASB Standards are to be understood, interpreted and applied.<sup>5</sup>
- The proposed revised ASA 101 will not include additional mandatory requirements (practical obligations on assurance practitioners) in addition to those included elsewhere in AUASB Standards. The AUASB has obtained independent legal advice on this matter that supports the position that specific additional requirements should be added to the relevant subject matter specific AUASB Standards (for example, by adding an “Aus” paragraph to a standard), instead of the primary (binding) section of the Preamble.

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<sup>2</sup> See ASA 101, paragraphs 5-6.

<sup>3</sup> ASQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Reports and Other Financial Information, or Other Assurance or Related Services Engagement*.

<sup>4</sup> See ASA 101, paragraph 5.

<sup>5</sup> See ED 02/21, paragraph 3.

- (c) **Move the requirement in ASA 101 (paragraph 11) that addresses the linkage to the relevant Parts of the Corporations Act to which the Auditing Standards apply (as applicable), to the “Application and Other Explanatory Material” section of the proposed standard.**
- Extant ASA 101 (paragraph 11), includes as a requirement a paragraph that identifies the relevant Parts of the Corporations Act to which the “Application” paragraph in each Auditing Standard that refers to audits or reviews conducted in accordance with the Corporations Act applies.
  - ED 02/21 includes this material in the “Application and Other Explanatory Material” section of the proposed standard (see paragraph A30-A32). The AUASB does not consider the extant paragraph 11 imposes any obligation on the assurance practitioner in addition to existing requirements contained in other Auditing Standards. Rather, the purpose of this paragraph is to provide further clarification of requirements included in Auditing Standards.
- (d) **Move the requirement in extant ASA 101 (paragraph 12) that addresses the documentation requirements when a requirement in an Auditing Standard is not relevant, to the “Application and Other Explanatory Material” section of the proposed standard.**
- Extant ASA 101 (paragraph 12), includes a specific requirement describing the circumstances when an auditor is not required to document the reason(s) why a requirement is not relevant.
  - ED 02/21 includes this paragraph in the “Application and Other Explanatory Material” section of the proposed standard (see paragraph A42), together with other related interpretive material to explain what requirements are, how requirements are drafted, how requirements are applied, and that AUASB Standards require compliance with relevant requirements.
  - As explained in paragraph 16(b) above, the purpose of ED 02/21 is limited to setting out how AUASB Standards are to be understood, interpreted and applied. Unlike extant ASA 101, ED 02/21 does not include mandatory “requirements” (practical obligations on assurance practitioners) in addition to those included elsewhere in AUASB Standards.
  - The AUASB has obtained independent legal advice on this matter that supports the position that paragraph 12 of extant ASA 101 is more appropriately placed in the “Application and Other Explanatory Material” section of ED 02/21.  
  
The basis for this position is that the difference in scope between extant ASA 101 and ED 02/21 determines the types of matters to be contained within the primary section of each standard. In light of the scope of extant ASA 101, mandatory requirements, such as paragraph 12, could be appropriately placed within the primary section of extant ASA 101. In contrast, the scope of the proposed revised ASA 101 does not provide for mandatory requirements to be included within the primary section of ED 02/21.
- ED 02/21 identifies the mandatory “components” of a standard that the assurance practitioner is required to apply relevant to the engagement. It also includes explanatory material to explain and clarify the purpose of application and other explanatory material included in AUASB Standards.
  - ED 02/21 identifies “requirements” as a subset of the mandatory “components” of a standard (see ED 02/21, paragraph 12).  
  
ED 02/21 does not include any other specific “requirements” (practical obligations on assurance practitioners) but includes application and other explanatory material to improve stakeholder understanding of “requirements” as one of the key mandatory components of AUASB Standards.

- ASA 200<sup>6</sup> and ASA 230<sup>7</sup> do not include a similar “requirement” to that set out in paragraph 12 of extant ASA 101. However, explanatory material in both standards explains that ASA 230 documentation requirements apply only to requirements that are relevant in the circumstances of the engagement – see:
    - ASA 200, paragraph A76: “ASA 230 establishes documentation **requirements** in those rare and exceptional circumstances where the auditor is unable to comply with a relevant requirement” (with a footnote reference to the **requirement** in ASA 230, paragraph Aus 12.1).
    - ASA 230 includes **explanatory material** related to paragraph Aus 12.1 clarifying in paragraph A19 that “the documentation requirement applies only to requirements that are relevant in the circumstances”.
  - The AUASB considers that the additional explanatory material included in ED 02/21, paragraphs A41-A43, provides sufficient clarification of the documentation requirements in circumstances where a requirement in a standard is not relevant.
  - As the extant ASA 101 only applies to ASAs, the existing paragraph 12 “requirement” of extant ASA 101 does not cover other AUASB Standards. The AUASB therefore considers that there is benefit in including an expanded version of paragraph 12 (from extant ASA 101) within ED 02/21, to expand the guidance to cover all AUASB Standards (see ED 02/21, paragraph A42). Independent legal advice obtained by the AUASB supports this position.
- (e) **Amend extant ASA 101 to include additional interpretive guidance, for example from the repealed ASA 100, to improve stakeholder understanding of the key components of AUASB Standards.**

ED 02/21 includes additional application and other explanatory material on the key components of AUASB Standards, including:

- (i) Relevant application and other explanatory material carried forward from ASA 100, updated as appropriate:
  - The “Introduction” to extant ASA 101 has been expanded to include relevant contextual material from ASA 100 – see ASA 100, paragraphs 2-8, 19 and 33-39.

Introductory material in ED 02/21 (see paragraphs 3-8 and A1-A25) now includes:

- Explanation of the purposes of the “Authority Statement” included in AUASB Standards (ED 02/21, paragraphs A1-A2).
- Background information on the types of standards issued by the AUASB, engagements these standards apply to, the status and authority of paragraphs included in standards, the legal status of standards, the application of professional judgement in applying AUASB Standards, as well as the requirement to comply with relevant ethical principles, including independence requirements, and quality management in conducting engagements that fall within the scope of AUASB Standards (ED 02/21, paragraph A3-A21).

Material carried forward from ASA 100 is supplemented by relevant material from, or references to, the *Foreword to AUASB Pronouncements* (paragraphs 6-9, 17-19), the IAASB’s *Preface to the*

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<sup>6</sup> ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.  
<sup>7</sup> ASA 230 *Audit Documentation*.

*International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements* (IAASB Preface) (paragraphs 5-19), ASA 200 (paragraphs 1-2, A55-A59), *Framework for Assurance Engagements* (paragraphs 5-9, 56) and ASQM 1 (paragraphs 1-5, 12).

- New content to explain the “Compilation Details” section that is included in the compiled version of an Auditing Standard, including the purpose of the tables within the Compilations Details (ED 02/21, paragraphs A22-A25).
- Explanation of the “Application” paragraph(s) included in AUASB Standards (ED 02/21, paragraphs A28-A32) – see ASA 100, paragraphs 20-24.

Paragraph A32 of ED 02/21 clarifies that Auditing Standards made under section 336 of the Corporations Act may include an additional “Application” paragraph (shown as paragraph “Aus 0.2”) that forms part of the explanatory material of the standard to explain that, although the Auditing Standards are written mainly in the context of an audit of a financial report, they apply also, adapted as necessary, to the audit of other historical financial information.

- Explanation of the “Operative Date” paragraph included in AUASB Standards (ED 02/21, paragraph A33) – see ASA 100, paragraph 25. This paragraph is now closer aligned to the wording of section 336(3) of the Corporations Act.

Additional explanatory material has been added to clarify that:

- AUASB Standards may be early adopted, unless expressly prohibited in the “Operative Date” paragraph of the standard (ED 02/21, paragraph A34). The proposed amended wording aligns with the IAASB Preface (paragraph 18), ISA 200<sup>8</sup> (paragraph A56) and section 336(4) of the Corporations Act.
- Where an assurance practitioner is conducting an audit of a financial report and elects to early adopt an Auditing Standard, in accordance with section 336(4) of the Corporations Act, that election must be recorded in the audit report (ED 02/21, paragraph A35).

The proposed amendments to ASA 101 will likely require further conforming amendments to be made to the following Auditing Standards once the revised preamble has been approved:

- ASA 200 – Amend to align the wording of paragraph A56 with that used in ISA 200, the IAASB Preface and ED 02/21 (paragraph A34).
- ASA 700 – Add an additional “Aus” paragraph to require that where an auditor is conducting an audit of a financial report and elects to early adopt an Auditing Standard, in accordance with section 336(4) of the Corporations Act, that election must be recorded in the audit report.

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<sup>8</sup> ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*.

## Explanatory Memorandum

### Exposure Draft 02/21: *Proposed Auditing Standard ASA 101 Preamble to AUASB Standards*

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- Explanation of the “Conformity with International Standards” paragraphs included in AUASB Standards with equivalent IAASB Standards (ED 02/21, paragraphs A45-A49) – see ASA 100, paragraphs 28-32.
- (ii) Relevant application and other explanatory material from ASA 200 (paragraphs A55-A78), ASAE 3000<sup>9</sup> (paragraphs A21-A28), and other relevant AUASB pronouncements<sup>10</sup>, or references to these pronouncements, where the AUASB considers this application and explanatory material will enhance stakeholder understanding of how AUASB Standards are to be understood, interpreted and applied, for example, to explain the:
- objective(s) stated in a standard (ED 02/21, paragraph A36).
  - definitions contained within a standard and/or within the AUASB Glossary (ED 02/21, paragraph A37).
  - requirements of a standard and how requirements are to be applied, how requirements are drafted, that requirements are to be applied in the context of other material included in the standard and to clarify the documentation requirements where requirements in standards are not relevant (ED 02/21, paragraphs A38-A44).
  - purpose, status and authority of introductory material included in a standard (ED 02/21, paragraph A50).
  - purpose, status and authority of material included in the “Application and Other Explanatory Material” section of a standard (ED 02/21, paragraphs A51-A53).
  - status and authority of Appendices included in standards (ED 02/21, paragraph A54).
- (iii) AUASB Drafting Principles
- ASA 100, paragraphs 45-48, sets out the drafting principles and conventions that have been adopted in the redrafting of AUASB Standards in 2006 in response to CLERP 9 (explained in paragraphs 8-9 of this document). Most of these principles no longer apply to AUASB Standards which have been redrafted in “clarity” format and reissued in 2009.
  - Extant ASA 101 does not include any explanation of the drafting principles applied in the redrafting of AUASB Standards in clarity format in 2009 (see paragraphs 10-11 of this document).
  - ED 02/21, paragraph A55, outlines the key principles and conventions applied in drafting AUASB Standards.
  - The IAASB, as part of its “Audit of Less Complex Entities” (LCE) project, is currently in the process of developing drafting principles and guidelines to address the complexity, understandability, scalability and proportionality (CUSP) in developing International Standards on Auditing. The AUASB will continue to monitor developments at the international level and, if necessary, update the AUASB Preamble at a future date to reflect these updated drafting principles and guidelines.

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<sup>9</sup> ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical financial Information*.

<sup>10</sup> Including ASA 100 (paragraph 14), ASQM 1 (paragraphs A6-A9), ASRE 2400 *Review of a Financial Report Performed by an Assurance Practitioner Who is Not the Auditor of the Entity* (paragraphs 9-12), ASRS 4400 *Agreed-Upon Procedures Engagements* (paragraphs 7-10).

## **Conformity with IAASB Standards**

17. ASA 101 relates to the Australian legislative environment and accordingly there is no equivalent International Standard on Auditing issued by the IAASB. Where relevant, the AUASB has aligned the wording of this Auditing Standard with the IAASB Preface.

## **Request for Comments**

18. The AUASB requests comments on all matters in relation to ED 02/21, but specifically in relation to the questions below. Stakeholders may address only specific questions relevant to them or raise matters not specifically addressed by a question.

### **Exposure Draft Questions**

The AUASB is seeking comments on ED 02/21 from stakeholders on the following questions:

1. Do you support the introduction of the proposed revised ASA 101 which will replace ASA 100 and extant ASA 101? If not, why not?

The AUASB prefers that respondents express a clear opinion on whether the proposed Auditing Standard, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on the matters below. The AUASB regards both supportive and critical comments as essential to a balanced review of the proposed Auditing standard.

2. 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?
3. Are there any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
4. What, if any, are the additional significant costs to/benefits for assurance practitioners and the business community arising from compliance with the main changes to the requirements of this proposed standard? If significant costs are expected, the AUASB would like to understand:
  - a. Where these costs are likely to occur;
  - b. The estimated extent of costs, in percentage terms (relative to fees); and
  - c. Whether expected costs outweigh the benefits to the users of assurance services?
5. Are there any other significant public interest<sup>11</sup> matters that stakeholders wish to raise?

The AUASB asks that comments are sufficiently detailed and include whether stakeholders agree or do not agree with the proposed amendments. The AUASB welcomes any other comments which are not specifically addressed by the questions above.

## **Application**

19. It is intended that the proposed Auditing Standard will be operative for engagements with financial reporting periods commencing on or after 1 October 2021. Early adoption of this Auditing Standard is permitted prior to this date.

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<sup>11</sup> The AUASB's *Public Interest Framework for the Development of AUASB Pronouncements* expands upon what the "public interest" means to the AUASB and provides a useful frame of reference for the AUASB to assess whether its standard-setting process is appropriate and responsive to the public interest. See Appendix 1 of the AUASB's *Due Process Framework for Developing, Issuing and Maintaining AUASB Pronouncements and Other Publications*.

## **Comment Date**

20. ED 02/21 will be open to stakeholders for a 30-day comment period, closing **31 July 2021**.
21. At the completion of the exposure period, the AUASB will consider stakeholders' submissions and make amendments to the proposed standard, where considered appropriate.

## **Additional Website Resources**

### *Mapping of changes to extant ASA 101*

22. ED 02/21 is available on the AUASB website. For further information, including tracking of the changes to ASA 101, refer to the following AUASB meeting papers:
  - (a) **April 2021, Agenda Item 4 -**
    - **Agenda Item 4.2 Revised ASA 101 marked up version**, which can be used to track changes made to the extant ASA 101. Comment boxes have been added to show the source of amendments/additions.
    - **Agenda Item 4.3 AUASB Agenda Paper Attachment**, which includes an analysis of the AUASB Preambles. Part B of this analysis includes a side by side comparison of ASA 100 and extant ASA 101 which will enable tracking of content carried forward from ASA 100 to the proposed revised ASA 101 (ED 02/21).
  - (b) **June 2021, Agenda Item 3.2 - Revised ASA 101 marked up from the April 2021 AUASB meeting.**

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# AUASB Agenda Paper

<b>Project:</b>	<b>Amendments to ASA 560</b>	<b>Meeting:</b>	8 June 2021
<b>Topic:</b>	<b>Amendments to ASA 560</b>	<b>Agenda Item:</b>	4.0
<b>Strategic Objective:</b>	Influence international standards and guidance to achieve public interest outcomes and serve as the most effective base possible for Australian auditing and assurance standards	<b>Decision-Making:</b>	For Discussion and Approval
<b>ATG Staff:</b>	See Wen Ewe	<b>Project Status:</b>	In Progress
<b>AUASB Sponsor:</b>	None		

## Action Required and Decisions to be Made

- 1 The AUASB is requested to review the following and provide feedback:
  - (a) Agenda Item 4.1 – Proposed Project Plan for Amendments to ASA 560
  - (b) Agenda Item 4.2 – Exposure Draft 03/21 Proposed Auditing Standard ASA 2021-2 *Amendments to Australian Auditing Standard ASA 560 Subsequent Events* (Draft)
  - (c) Agenda Item 4.3 – Explanatory Memorandum: Exposure Draft 03/21 Proposed Auditing Standard ASA 2021-2 *Amendments to Australian Auditing Standard ASA 560 Subsequent Events* (Draft)
- 2 The AUASB is requested to approve ED 03/21 and the Explanatory Memorandum.



## ATG Recommendations Overview and Questions for the Board

Question No.	Question for the Board	ATG Recommendation Overview
Question 1	Does the AUASB agree with the scope of this project or have any other comments on the project plan?	The ATG recommends that the project plan at Agenda Item 4.1 is approved by the AUASB.
Question 2	Does the AUASB agree with the proposed effective date?	The ATG recommends that the proposed effective date of the amendments is for financial reporting periods commencing on or after 15 December 2021.
Question 3	Does the AUASB agree with ATG's proposal of making the amendments through an amending standard?	Given the narrow scope change of this project, the ATG proposes to make the amendments through an amending standard instead of issuing a new standard.
Question 4	Does the AUASB agree with the proposed amendments or have any other comments on the ED 03/21 or the Explanatory Memorandum?	The ATG recommends that the ED is approved by the AUASB.

## Background

- 3 The Financial Markets Authority New Zealand (FMA) raised concerns with the New Zealand Auditing and Assurance Standards Board (NZAuASB) about how to ensure that investors and other stakeholders are informed in a timely manner that they cannot rely on the audit opinion, when a fact becomes known to the auditor after the financial reports have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report.
- 4 FMA also raised the practical difficulties that auditors face about how to inform users of the financial reports that they cannot rely on the auditor opinion attached to the financial reports.
- 5 In November 2019, the NZAuASB issued an [exposure draft](#) seeking feedback on the amendments made to ISA (NZ) 560, *Subsequent Events*.
- 6 At the February 2020 NZAuASB Meeting, the NZAuASB approved limited proposed changes to [ISA \(NZ\) 560, Subsequent Events](#).

## Previous Discussions on Topic

- 7 This issue was first brought to the AUASB's attention at the December 2019 AUASB meeting as part of the NZAuASB's Chair update. At the meeting, it was agreed that this topic will be



reviewed by the AUASB Technical Group and presented for consideration at a later AUASB meeting.

## Matters for Discussion and ATG Recommendations

- 8 In accordance with its mandates under section 227 of the *ASIC Act 2001* and the Financial Reporting Council's (FRC) Strategic Direction, the AUASB's policy is to adopt the IAASB's auditing standards (ISAs), unless there are compelling reasons not to do so, and to amend the ISAs only when there are compelling reasons to do so. Compelling reasons fall broadly into two categories: legal and regulatory; and principles and practices considered appropriate in maintaining or improving audit quality in Australia.
- 9 Under the AUASB's Principles of Convergence and Harmonisation Policy, harmonisation is therefore ideally achieved by adopting modifications made to an IAASB standard by one country that have relevance and application in the other country.
- 10 Furthermore, it is in the public interest to ensure that investors and other stakeholders are informed in a timely manner when an audit opinion is found to be incorrect.
- 11 Based on the reasons mentioned above, the ATG proposes to develop an Exposure Draft in Australia which incorporates the limited amendments to ASA 560 *Subsequent Events*.
- 12 A project plan has been drafted for the purpose of this project, see **Agenda Item 4.1**.
- 13 The scope of this project will be solely for the purpose to:
  - (a) clarify the timing of communications and possible actions the auditor may take when facts become known to the auditor after the financial report has been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report; and
  - (b) add guidance about possible steps the auditor could take to prevent reliance on the auditor's report.

### Questions

1. Does the AUASB agree with the scope of this project or have any other comments on the project plan?

- 14 The proposed effective date of the amendments is for financial reporting periods commencing on or after 15 December 2021, with early adoption permitted. Ordinarily, the AUASB standards have effective dates of 15 December following the international standards, however given the limited nature of amendments, it is anticipated that the amendments can go into effect almost immediately.

### Questions

2. Does the AUASB agree with the proposed effective date?



15 Normally, when there is a significant change to an existing standard, a revised standard would be issued. Currently, amending standards are commonly drafted for the purposes of conforming amendments arising from a revised standard. However, given the narrow scope amendments to ASA 560 as a result of this project, the ATG proposes to update ASA 560 through an amending standard instead of issuing a new standard.

(a) The pros of issuing an amending standard:

- (i) The amendments will be compiled together with previous compilations, hence previous compilation information will be retained.
- (ii) Federal Register of Legislation charges all legislative instruments by number of pages. An amending standard will have fewer pages than a full standard, hence cost saved.

(b) The cons of issuing an amending standard:

- (i) When a new standard is issued details of why the standard has been revised are included in the Preface. By issuing the changes to ASA 560 as an amending standard this information normally included in the Preface will not be explicitly stated in the compiled version (however the information will be fully disclosed in the accompanying Explanatory Memorandum).

The ATG proposes that an amending standard is suitable for the update to ASA 560 as the overall objective and requirements of the standard have not changed. In future the ATG would also recommend similar 'limited scope' amendments to auditing standards are also updated using this approach.

16 The proposed amendments affect paragraphs 14, 17 of the extant ASA 560 and include a new paragraph Aus A20.1 to the extant, see **Agenda Item 4.2**.

## Questions

- 3. Does the AUASB agree with ATG's proposal of making the amendments through an amending standard?
- 4. Does the AUASB agree with the proposed amendments or have any other comments on the ED 03/21 or the Explanatory Memorandum?

## Next steps/Way Forward

17 Subject to AUASB's approval of ED 03/21 and the Explanatory Memorandum, the ATG will incorporate the comments raised by the AUASB and both documents will be posted on the AUASB website. A communication email will be sent to stakeholders listed in the project plan.



- 18 The ED will be exposed for a 45-day comment period. The ATG will present a summary of the comments received to the AUASB at the September 2021 AUASB meeting, with a view to have the revised standard approved.

## Materials Presented

Agenda Item	Description
4.1	Proposed Project Plan for Amendments to ASA 560
4.2	Exposure Draft 03/21 Proposed Auditing Standard ASA 2021-2 <i>Amendments to Australian Auditing Standard ASA 560 Subsequent Events</i> (Draft)
4.3	Explanatory Memorandum: Exposure Draft 03/21 Proposed Auditing Standard ASA 2021-2 <i>Amendments to Australian Auditing Standard ASA 560 Subsequent Events</i> (Draft)



# AUASB Project Plan

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<b>Project Title:</b>	Amendments to ASA 560
<b>Date Prepared:</b>	11 May 2021
<b>Date Approved:</b>	
<b>ATG Member:</b>	See Wen Ewe
<b>AUASB Member:</b>	
<b>Version number:</b>	1

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## Overview of Project

### Information Gathering/Background

*Why is this being brought to the AUASB's attention?*

- In February 2020, the NZAuASB Board approved limited proposed changes to ISA (NZ) 560, *Subsequent Events*, to clarify the timing communications and possible actions the auditor may take when a fact becomes known after issuing the auditor's report and, had it been known to the auditor at the date of the report, may have caused the auditor to amend the auditor's report.
- This issue was first brought to AUASB's attention at the December 2019 AUASB meeting as part of the NZAuASB's Chair update.
- As part of AUASB's strategic objectives to maintain harmonisation of auditing and assurance standards in Australia and New Zealand in accordance with relevant agreements and protocols, there is an urgency to update ASA 560 as ISA (NZ) 560 is effective for periods beginning on or after 15 July 2020.

*What information gathering has been completed to date?*

- The Financial Markets Authority New Zealand (FMA) first raised the issue in 2018 that they have had auditors experienced subsequent to issuing their audit opinions, where the audit opinion was either incorrect or the evidence no longer supported their opinion.
- The FMA considered that it is in the public interest for investors and other stakeholders to be informed in a timely manner when an audit opinion is found to be incorrect.
- However, FMA acknowledged the practical difficulties the auditors face about how to inform users of the financial statements that they cannot rely on the audit opinion attached to the financial statements.
- As a result, NZAuASB issued an [exposure draft](#) seeking feedback on the proposed amendments to ISA (NZ) 560, *Subsequent Events*, in November 2019.
- The amendments were made to paragraphs 14, 17 and NZ A20.1 of the revised ISA (NZ) 560.

- The amending standard was then approved by the NZAuASB at the [February 2020 NZAuASB meeting](#).
- Under the AUASB's Principles of Convergence and Harmonisation Policy, all AUASB Standards are developed and issued in accordance with the principles of harmonisation policy with New Zealand Standards and AUASB/NZAuASB communication protocols. Harmonisation is therefore ideally achieved by adopting modifications made to an IAASB standard by one country that have relevance and application in the other country.
- This issue is not limited to a particular stakeholder group hence the AUASB Technical Group (ATG) proposed to issue an exposure draft to various stakeholder groups to gather feedback.

*What additional information gathering needs to be completed and why?*

- The ATG has incorporated the amendments made by the NZAuASB in ED 03/21 Proposed Auditing Standard ASA 2021-2 *Amendments to Australian Auditing Standard ASA 560 Subsequent Events*.
- Given the limited scope, the ED will be exposed for a 45-day comment period.

*Who are the relevant stakeholders and have they provided input to the information gathering?*

- Given the limited scope of amendments, an outreach is not deemed necessary.
- All Australian stakeholders are relevant to this project hence the exposure draft will be communicated via newsletters and social media channels. In addition, a targeted email will be sent to ASIC, CPA Australia, CA ANZ, PwC, KPMG, EY, Deloitte, BDO and Grant Thornton.

## Scope

**What is the problem we are trying to solve (project objective)?**

*What are the major issues that need to be addressed?*

- Inconsistencies between extant ASA 560 *Subsequent Events* and ISA (NZ) 560, *Subsequent Events*, which was revised on 27 February 2020.

*Project Objective*

- The objective of this project is to amend ASA 560 to align the requirements with ISA (NZ) 560.

*Project Scope*

- Propose amendments to Australian Auditing Standard ASA 560 *Subsequent Events* to clarify the timing of communications and possible actions the auditor may take when facts become known to the auditor after the financial reports have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report; and
- To add guidance about possible steps the auditor could take to prevent reliance on the auditor's report.

### Issues Out of Scope of this project

- Any potential issues identified apart from the project scope mentioned above will not be included as part of this project.

### What AUASB output will best respond to this?

- An exposure draft will be drafted to respond to this issue and seek feedback from Australian stakeholders.

## Project Governance

### Why is this in the public interest?

- It is in the public interest to ensure that investors and other stakeholders are informed in a timely manner when an audit opinion is found to be incorrect, especially in the current environment where situations could change in a short period of time (ie. border closures due to COVID-19 pandemic).
- This project relates to AUASB Strategic Objective three - influence international standards and guidance to achieve public interest outcomes and serve as the most effective base possible for Australian auditing and assurance standards and meets AUASB Performance Measure five - maintain harmonisation of auditing and assurance standards in Australia and New Zealand in accordance with relevant agreements and protocols.

### Targeted Implementation Date

- Subject to AUASB approval of the exposure draft at the June AUASB meeting, the exposure draft will be released for public comment for a 45-day comment period.
- The ATG will present a summary of the comments received to the AUASB at the September 2021 AUASB meeting, with a view to have the revised standard approved.
- The proposed effective date of the amendment is for financial reporting periods commencing on or after 15 December 2021, with early adoption permitted.
- As the amendments are limited in nature, the ATG does not expect a lengthy transition period.

### Action Plan

- Refer table below.

Date	Description	Date	NZAuASB Timing (if applicable)
8 Jun 2021	Initial discussion, project plan and ED approval	N/A	N/A
7 & 10 Sep 2021	Amending Standard approval	N/A	N/A

## Communication with stakeholders

- Given the limited scope of changes, an outreach is not deemed necessary.
- All Australian stakeholders are relevant to this project hence the exposure draft will be communicated through newsletters and social media channels. In addition, a targeted email will be sent to ASIC, assurance practitioners and professional bodies.

## Risks/Issues

Risk/Issue	Mitigation	Related Action
<i>Potentially opens up other issues in ASA 560</i>	<i>The limited scope has been clearly outlined in both Explanatory Memorandum and Exposure Draft.</i>	<i>The limited scope has been clearly outlined under paragraphs 12 and 13 of the Explanatory Memorandum and paragraph 4 of the Exposure Draft.</i>

## Should an external resource be used?

- No external resource is needed for this project.

## Version Control

Version number	Approval Date	Minute number	Amendment Made	
			Relevant Section	Description
1			N/A	N/A

EXPOSURE DRAFT

**ED 03/21**  
(June 2021)

# **Proposed Auditing Standard ASA 2021-2** *Amendments to Australian Auditing Standard ASA 560 Subsequent Events*

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

Draft



**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 **[30 July 2021]**. Comments should be addressed to:

The Chairman  
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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*Draft*

## PREFACE

### Reasons for Issuing ED 03/21

The AUASB issues exposure draft ED 03/21 of proposed Auditing Standard ASA 2021-2 *Amendments to Australian Auditing Standard ASA 560 Subsequent Events* 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.

### Main Proposals

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

ASA 560 *Subsequent Events* (Issued October 2009 and amended to December 2015)

The Explanatory Memorandum: Exposure Draft 03/21 Proposed Auditing Standard ASA 2021-2 *Amendments to Australian Auditing Standard ASA 560 Subsequent Events* (Explanatory Memorandum) provides an overview of the proposed amendments.

### Proposed Operative Date

It is intended that this proposed Auditing Standard will be operative for financial reporting periods commencing on or after 15 December 2021.

### Request for Comments

Comments are invited on this Exposure Draft of the proposed issuance of ASA 2021-2 *Amendments to Australian Auditing Standard ASA 560 Subsequent Events* by no later than **30 July 2021**. The AUASB is seeking comments from respondents on the following questions:

1. Are the proposed amendments to ASA 560 to clarify the timing of the auditor's communication to management and, where appropriate, those charged with governance when facts become known to the auditor after the financial report (and related auditor's report) have been issued helpful?
2. Is paragraph Aus A20.1(b) clear about who the auditor may consider notifying?
3. Do respondents have any other comments on ED 03/21 (please be specific)?
4. Do respondents support the proposed effective date? If not, please explain why not.
5. Have applicable laws and regulations been appropriately addressed in the proposed amendments to ASA 560? Are there any references to relevant laws or regulations that have been omitted?

**Proposed Auditing Standard ASA 2021-2**  
***Amendments to Australian Auditing Standard ASA 560 Subsequent Events***

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6. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed amendments to ASA 560, or may conflict with the proposed amendments to ASA 560?
7. 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 amendments to ASA 560, or may conflict with the proposed amendments to ASA 560?
8. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed amendments to ASA 560? If significant costs are expected, the AUASB would like to understand:
  - (i) Where those costs are likely to occur;
  - (ii) The estimated extent of costs, in percentage terms (relative to audit fees); and
  - (iii) Whether expected costs outweigh the benefits to the users of audit services?
9. Are there any other significant public interest matters that stakeholders wish to raise?

The AUASB ask that comments are sufficiently detailed and include whether stakeholders agree or do not agree with the proposed amendments. The AUASB welcome any other comments which are not specifically addressed by questions above.

*Draft*

**AUTHORITY STATEMENT**

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 2021-2 *Amendments to Australian Auditing Standard ASA 560 Subsequent Events* pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

Draft

### **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).

*Draft*

## AUDITING STANDARD ASA 2021-2

### *Amendments to Australian Auditing Standard ASA 560 Subsequent Events*

#### Application

1. This Auditing Standard applies to:
  - 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
  - an audit of a financial report, or a complete set of financial statements, for any other purpose.
2. This Auditing Standard also applies, as appropriate, to an audit of other historical financial information.

#### Operative Date

3. This Auditing Standard is operative for financial reporting periods commencing on or after 15 December 2021, with early adoption permitted.

#### Introduction

##### Scope of this Auditing Standard

4. This Auditing Standard makes amendments to Australian Auditing Standard ASA 560 *Subsequent Events* made under Section 336 of the *Corporations Act 2001* to clarify the timing of communications and possible actions the auditor may take when facts become known to the auditor after the financial reports have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report.

#### Objective

5. The objective of this Auditing Standard is to make amendments to Australian Auditing Standard ASA 560 *Subsequent Events* (Issued October 2009 and amended to December 2015).

#### Definition

6. For the purposes of this Auditing Standard, the meanings of terms are set out in each Auditing Standard and in the *AUASB Glossary*. This Auditing Standard does not introduce new definitions.

#### Amendments to Auditing Standard

7. This Standard uses underlining, striking out and other typographical material to identify the amendments to Auditing Standards, in order to make the amendments more understandable. However, the amendments made by this Standard do not include that underlining, striking out or other typographical material. Amended paragraphs are shown with deleted text struck through and new text underlined. Ellipses (...) are used to help provide the context within which amendments are made and also to indicate text that is not amended.

#### Amendments to ASA 560

8. Existing paragraph 14 is amended to read as follows:

[Deleted by the AUASB. Refer Aus 14.1.]

**Proposed Auditing Standard ASA 2021-2**  
***Amendments to Australian Auditing Standard ASA 560 Subsequent Events***

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9. The following new paragraph Aus 14.1 is inserted following existing paragraph 14 of this Auditing Standard:

After the financial report has been issued, the auditor has no obligation to perform any audit procedures regarding such financial report. However, if, after the financial report has been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:

- (a) Discuss the matter with management and, where appropriate, those charged with governance within a reasonable period of time;
- (b) Determine whether the financial report needs amendment and; if so,
- (c) Enquire how management intends to address the matter in the financial report.

10. Existing paragraph 17 is amended to read as follows:

If management, or those charged with governance, do not take the necessary steps to ensure that anyone in receipt of the previously issued financial report is informed of the situation and does not amend the financial report in circumstances where the auditor believes they need to be amended, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity,<sup>7</sup> those charged with governance, that the auditor will seek to prevent future reliance on the auditor's report. If, despite such notification, management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report.

(Ref: Para. A20-Aus A20.1)

11. The following new paragraph Aus A20.1 is inserted following existing paragraph A20 of this Auditing Standard:

Unless legal advice obtained recommends a different course of action, possible actions the auditor may consider include:

- (a) Notifying management and those charged with governance that the auditor's report must no longer be associated with the financial report;
- (b) If applicable, notifying the appropriate authority having jurisdiction over the entity that the auditor's report should no longer be relied upon, and requesting the authority to take steps to provide appropriate disclosure.
- (c) If practicable, notifying each person known to the auditor to be relying on the financial report that the auditor's report should no longer be relied upon.

June 2021

# **Explanatory Memorandum**

## **Exposure Draft 03/21 Proposed Auditing Standard ASA 2021-2**

### *Amendments to Australian Auditing Standard ASA 560 Subsequent Events*

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

*Draft*



**Australian Government**  
**Auditing and Assurance Standards Board**

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This Explanatory Memorandum is available on the Auditing and Assurance Standards Board (AUASB) website: [www.auasb.gov.au](http://www.auasb.gov.au)

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*Draft*

## **EXPLANATORY MEMORANDUM**

### **Exposure Draft 03/21 Proposed Auditing Standard ASA 2021-2 Amendments to Australian Auditing Standard ASA 560 Subsequent Events**

#### **Purpose**

1. The AUASB is seeking feedback from stakeholders on proposed amendments to ASA 560 *Subsequent Events*, which are detailed in Exposure Draft 03/21 Proposed Auditing Standard ASA 2021-2 *Amendments to Australian Auditing Standard ASA 560 Subsequent Events* (ED 03/21).
2. The aim of this Explanatory Memorandum is to provide stakeholders with information about ED 03/21.

#### **Background**

3. The AUASB has a strategic objective to develop, issue and maintain high quality Australian Auditing Standards. The AUASB takes input received from Australian stakeholders into account when developing Australian Auditing Standards.
4. In 2019, the Financial Markets Authority New Zealand (FMA) raised concerns with the New Zealand Auditing and Assurance Standards Board (NZAuASB) about how to ensure that investors and other stakeholders are informed in a timely manner that they cannot rely on the audit opinion, when a fact becomes known to the auditor after the financial reports have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report.
5. There are practical difficulties that auditors face about how to inform users of the financial reports that they cannot rely on the auditor opinion attached to the financial reports. As a result, the NZAuASB amended ISA (NZ) 560 *Subsequent Events* to add guidance about possible steps the auditor could take to prevent reliance on the auditor's report.
6. At the February 2020 NZAuASB meeting, the NZAuASB approved limited proposed changes to [ISA \(NZ\) 560, Subsequent Events](#), to clarify the timing communications and possible actions the auditor may take when a fact becomes known after issuing the auditor's report and, had it been known to the auditor at the date of the report, may have caused the auditor to amend the auditor's report.
7. Consistent with the AUASB's principle of harmonisation with the NZAuASB, the AUASB has agreed to develop an Exposure Draft in Australia which incorporates the limited amendments to ASA 560 *Subsequent Events*.
8. The AUASB considers that it is in the public interest to ensure that investors and other stakeholders are informed in a timely manner when an audit opinion is found to be incorrect. Accordingly, the AUASB has developed an Exposure Draft in Australia which incorporates the limited amendments to ASA 560 *Subsequent Events*.

#### **Conformity with IAASB's auditing standards**

9. In accordance with its mandates under section 227 of the *ASIC Act 2001* and the Financial Reporting Council's (FRC) Strategic Direction, the AUASB's policy is to adopt the IAASB's auditing standards (ISAs), unless there are compelling reasons not to do so, and to amend the ISAs only when there are compelling reasons to do so.
10. Under the AUASB's Principles of Convergence and Harmonisation Policy both the AUASB and NZAuASB agree to adopt IAASB Standards and only consider making modifications to the IAASB Standards if modifications are in the public interest and do not conflict with, or result in lesser requirements than, the international standards. Harmonisation is therefore ideally achieved by adopting modifications made to an IAASB standard by one country that

have relevance and application in the other country. The AUASB's principles of convergence with the ISAs and harmonisation with the New Zealand auditing standards can be found on the AUASB's website.

11. Compelling reasons fall broadly into two categories: legal and regulatory; and principles and practices considered appropriate in maintaining or improving audit quality in Australia. Compelling reasons are further guided by the AUASB's policy of harmonisation with the standards of the NZAuASB.
12. Extant ASA 560 conforms with International Standard on Auditing ISA 560. The proposed amendments contained in ED 03/21 add to existing requirements of ISA 560 and consequently the AUASB considers that the proposed amendment to ASA 560 conforms with ISA 560.

### **Key proposals contained in ED 03/21**

13. ED 03/21 proposes amendments to ASA 560 to clarify the timing of communications and possible actions the auditor may take when facts become known to the auditor after the financial reports have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report.
14. The purpose of the proposed amendments to ASA 560 is to add guidance about possible steps the auditor could take to prevent reliance on the auditor's report.

*Draft*

### **Exposure Draft Questions**

The AUASB is seeking comments on ED 03/21 from stakeholders on the following questions:

1. Are the proposed amendments to ASA 560 to clarify the timing of the auditor's communication to management and, where appropriate, those charged with governance when facts become known to the auditor after the financial report (and related auditor's report) have been issued helpful?
2. Is paragraph Aus A20.1(b) clear about who the auditor may consider notifying?
3. Do respondents have any other comments on ED 03/21 (please be specific)?
4. Do respondents support the proposed effective date? If not, please explain why not.
5. Have applicable laws and regulations been appropriately addressed in the proposed amendments to ASA 560? Are there any references to relevant laws or regulations that have been omitted?
6. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed amendments to ASA 560, or may conflict with the proposed amendments to ASA 560?
7. 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 amendments to ASA 560, or may conflict with the proposed amendments to ASA 560?
8. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed amendments to ASA 560? If significant costs are expected, the AUASB would like to understand:
  - (i) Where those costs are likely to occur;
  - (ii) The estimated extent of costs, in percentage terms (relative to audit fees); and
  - (iii) Whether expected costs outweigh the benefits to the users of audit services?
9. Are there any other significant public interest matters that stakeholders wish to raise?

The AUASB ask that comments are sufficiently detailed and include whether stakeholders agree or do not agree with the proposed amendments. The AUASB welcome any other comments which are not specifically addressed by questions above.

### **Application**

15. The proposed effective date of the amendment is for financial reporting periods commencing on or after 15 December 2021, with early adoption permitted.

### **Comment Date**

16. Comments to the AUASB will close on **[30 July 2021]**.
17. At the completion of the exposure period, the AUASB will consider stakeholders' submissions.

### **Website Resources**

18. ED 03/21 is available on the AUASB website.



# AUASB Agenda Paper

<b>Project:</b>	<b>ASA 315 <i>Identifying and Assessing the Risks of Material Misstatement</i></b>	<b>Meeting:</b>	8 June 2021
<b>Topic:</b>	<b>Implementation support plan</b>	<b>Agenda Item:</b>	5.1
<b>Strategic Objective:</b>	Develop Australian specific Guidance where required.	<b>Decision-Making:</b>	For Discussion and AUASB input
<b>ATG Staff:</b>	Anne Waters	<b>Project Status:</b>	In Progress
<b>AUASB Sponsor:</b>	Bill Edge		

## Action Required and Decisions to be Made

- 1 The purpose of this Agenda Paper is to seek AUASB support and input on the Australian implementation activities and support materials to be developed by the AUASB Technical Group for ASA 315 *Identifying and Assessing the Risks of Material Misstatement* (ASA 315).
- 2 **ATG Recommendations Overview and Questions for the Board**

Question No.	Question for the Board	ATG Recommendation Overview
Question 1	The AUASB is requested to provide any input into the proposed Australian Implementation Support activities as outlined in this paper.	Support planned implementation activities.

## Background

- 1 ASA 315 is operative for financial reporting periods commencing on or after 15 December 2021 i.e. December 2022 / June 2023 year ends.
- 2 At its meeting on 4 February 2020 the AUASB approved ASA 315 noting it is complex in nature and comprehensive implementation guidance was critical to assist practitioners and to ensure the objectives in enhancing the standard would be achieved.

- 3 To date the IAASB have released the following which are available on the [AUASB](#) website:
  - IAASB Introduction to ISA 315; and
  - IAASB Non-Authoritative Support Material: Using Automated Tools and Techniques when Identifying Risks
- 4 The IAASB are also developing further guidance materials detailed in their [implementation support plan](#) which includes:
  - a first-time implementation guide;
  - fact sheets; and
  - frequently asked questions (FAQs)

These are due to be completed by the end of June 2021.

- 5 At this stage the ATG do not know the exact content of the IAASB's guidance and whether this will address all topics we have identified as requiring some guidance (refer Appendix 1 for a list of possible FAQs). The ATG will review the IAASB's implementation guidance as it is issued and will then assess if there is a need to supplement this with further Australian developed guidance materials.
- 6 Based on the implementation date the ATG consider that implementation support should be issued by October 2021 to allow auditors time to amend methodologies. So, the ATG will commence development of further guidance to meet this timeline if considered necessary.

## ***Proposed Australian implementation activities and support materials***

### ***Phase 1: Awareness (during 2021 note already commenced)***

- Develop a dedicated ASA 315 page on the AUASB website where all support materials, are collated to facilitate easy access by AUASB stakeholders.
- Monitor and promote IAASB implementation support materials through the AUASB landing page as materials are issued.
- Present at CAANZ Audit Conference in May 2021.
- Implementation support for scalability for LCEs to be developed as a priority with the aim to release in July 2021.
- Conduct a webinar in October 2021 with overview of key changes and to promote the implementation support materials available.
- Develop series of staff FAQs – largely around the key changes and understanding of the operation of the standard. Examples of staff FAQs that can be developed is included at **Appendix 1** to this paper.

### ***Phase 2: Monitor implementation (during 2022)***

- Engage with professional bodies for the AUASB to provide updates and present at their various seminars and conferences as considered necessary.
- Continue to monitor implementation by attendance at auditor forums and request feedback on whether further activities are required.

## 1. Appendix 1

**Examples of staff FAQs** Based on feedback previous feedback from AUASB members and consideration by the ATG, the following has been identified where guidance would be beneficial for practitioners:

- What's changed?
- When is design and implementation testing of controls required?
- Is it possible to do a fully substantive audit and not gather an understanding of the entity's system of internal controls and not test any controls?
- How to identify and assess inherent risk?
- If an inherent risk factor is relevant to an assertion does that mean there is a ROMM?
- Do I need to document why IRF aren't relevant to all COTABD?
- How to assess control risk?
- How to combine inherent and control risk to assess ROMM?
- When do I need to test General IT Controls?
- Is it possible to not have any significant risks?
- What documentation requirements exist?
- How ASA 315 may be scalable for audits of less complex entities (LCEs)?



# AUASB Agenda Paper

<b>Project:</b>	<b>Quality Management Standards</b>	<b>Meeting:</b>	June 2021
<b>Topic:</b>	<b>Implementation support plan</b>	<b>Agenda Item:</b>	5.2
<b>Strategic Objective:</b>	Develop Australian specific Guidance where required.	<b>Decision-Making:</b>	For Discussion and AUASB input
<b>ATG Staff:</b>	Rene Herman	<b>Project Status:</b>	In Progress
<b>AUASB Sponsor:</b>	Gareth Bird/Julie Crisp		

## Action Required and Decisions to be Made

1 The purpose of this Agenda Paper is to seek AUASB support and input on the proposed QM standards Australian implementation activities and support materials to be developed by the AUASB Technical Group

### 2 ATG Recommendations Overview and Questions for the Board

Question No.	Question for the Board	ATG Recommendation Overview
<b>Question 1</b>	The AUASB is requested to provide any input into the proposed Australian Implementation Support activities as outlined in this paper.	Support planned implementation activities.

## Background

- Systems of quality management in compliance with ASQM 1 are required to be designed and implemented by 15 December 2022 (impacting June 2023 year ends), and the evaluation of the system of quality management is required to be performed within one year following 15 December 2022 (impacting June 2024 year ends).
- At the March 2021 AUASB meeting, the AUASB approved the 3 Quality Management standards (ASQM 1, ASQM 2 and ASA 220) noting it is complex in nature and comprehensive implementation guidance was critical to assist practitioners and to ensure the objectives in enhancing the standard would be achieved.

5. The IAASB has committed to implementation support materials as detailed in their [implementation support plan](#) which includes FAQs, first time implementation guides, webinars and fact sheets. Support materials are expected to be issued in the latter part of 2021.

## ***Proposed Australian implementation activities and support materials – through Q3 and Q4 2021***

### ***Phase 1: Awareness***

6. Develop a dedicated QM-standards landing page on the AUASB website where all support materials, from all around the globe, are collated to facilitate easy access by AUASB stakeholders.
7. Monitor and promote IAASB implementation support materials through the AUASB landing page.
8. Develop webinars – introduction to the standards/significance of key changes (in the absence of IAASB materials).
9. Outreach with small practitioners to understand implementation support needs. Share outcomes with the AUASB and the professional bodies.
10. Develop series of staff FAQs – largely around the understanding of the operation of the standard (educative materials). Examples of staff FAQs that can be developed is included at **Appendix 1** to this paper.

### ***Phase 2: Implementation and Collaboration***

11. Engage with professional bodies for the AUASB to provide QM standard updates at their various seminars and conferences.
12. Develop series of staff FAQs/other support materials based on the outcomes of the outreach from paragraph 9 above.
13. The AUASB Technical group, proposes outreach to other NSSs including New Zealand and Canada to understand implementation support activities being done in various jurisdictions and to seek input on proposed Australian implementation support materials as deemed appropriate by the AUASB Technical Group.
14. Proactively engage with APESB Technical staff to determine whether any joint implementation guidance could be issued particularly with reference to non-assurance practitioners.
15. Determine further activities if required.

## 1. Appendix 1

### **Examples of staff FAQs – this list is not exhaustive and does not cover all components of the system of quality management**

#### *General*

- (a) When is this standard effective for and does the system need to be fully up and running by the effective date?
- (b) Does the system of quality management cover all engagements performed by the firm?
- (c) Is the firm required to have all eight components in its system of quality management?

#### *Risk Assessment Process*

- (d) Is the firm required to identify and document all risks that could affect the achievement of quality objectives?
- (e) What factors does the firm consider in assessing the quality risks?
- (f) Is the firm required to design and implement responses for every risk that has been identified?

#### *Governance and Leadership*

- (g) What actions can a firm take to establish a culture that promotes a commitment to quality?

#### *Relevant Ethical*

- (h) Are the firm's responses required to also address the independence of other network firms or personnel in other network firms?

#### *Resources*

- (i) What is a firm expected to do when it uses an IT application from a service provider in its system of quality management?

#### *Communication*

- (j) How is the firm expected to communicate information, and does it always need to be formally documented?

#### *Monitoring and Remediation*

- (k) Are there monitoring activities other than inspection of engagements that a firm is able to use to monitor the system of quality management?
- (l) How frequently should monitoring activities be undertaken?



## AUASB Agenda Paper

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<b>Project:</b>	<b>Less Complex Entities</b>	<b>Meeting:</b>	June 2021
<b>Topic:</b>	<b>Separate Standard – ISA for LCE</b>	<b>Agenda Item:</b>	6.1
<b>Strategic Objective:</b>	Influence international standards and guidance to achieve public interest outcomes and serve as the most effective base possible for Australian auditing and assurance standards	<b>Decision-Making:</b>	For Discussion and AUASB input
<b>ATG Staff:</b>	Rene Herman	<b>Project Status:</b>	IAASB – Exposure Draft ISA for LCE
<b>AUASB Sponsor:</b>	TBA		

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### AUASB Action Required and Decisions to be Made

- 1 The purpose of this Agenda Item is to take the **AUASB through the key principles and operation of the separate ISA for LCE and receive input from the AUASB**. There is no issues paper presented for this Agenda Item, rather the ATG have prepared a series of slides.
- 2 The ATG along with Prof Roger Simnett (IAASB LCE working group member) will take the AUASB through the **slide deck** as presented at Agenda Item 6.1.1 and seek AUASB input/comment on a series of questions.
- 3 The **draft proposed exposure draft at Agenda Item 6.1.2 has been included for the attention of the AUASB**. There is also a hyperlink to the proposed exposure draft [\[here\]](#). It is not expected that AUASB members read every word of the proposed standard, but rather that AUASB members have a feel for the structure, flow and general content of the proposed standard.

# Audits of Less Complex Entities

## June 2021 AUASB Meeting



# Agenda

## Background/Principles

- Where is the IAASB at?
- Principles on which the LCE Standard is premised
- Objectives of the LCE Standard
- Format of the ISA for LCE

## Operation of the Standard – Questions for the AUASB

- Authority of the LCE Standard
- Qualitative characteristics complexity
- Areas to highlight
- ISA requirements into LCE standard
- Australian considerations
- Way forward



# Where is the IAASB at?

- IAASB commonly hearing about complexity. Three pronged approach, CUSP, separate LCE Standard and Framework for Activities
- December 2020 IAASB approved LCE project proposal
- Some concerns expressed by IAASB members
- PIOB strong supporter of separate standard
- Need an international solution
- Seen as part of a NSS's toolkit, (does it need to be adopted in Australia?)
- Aim is June 2021 ED vote
- Extended exposure period - 6 months



# Principles on which the LCE standard is premised



**Needs to provide same level of reasonable assurance**



**Based on the ISAs – same Risk-based approach**



**Requirements to be:**

- Principles based
- Those which apply to an LCE audit for within scope entities
- Focused on the expected output of the requirement
- Based on the ISAs – considered core to the audit of an LCE



**LCE audit undertaken in compliance with Ethical requirements and QM standards**



**Reasonable assurance opinion, but distinguish (covered later)**



# Objectives of the LCE Standard



Delivers a **high-quality audit** that maintains the degree of confidence for the intended users



Delivers an audit that will result in a **reasonable assurance opinion**



Able to be used **effectively and efficiently** to be able to obtain SAAE



Promotes **consistency in application** – clear and understandable requirements



**Proportionate to the public interest benefits** of using a separate standard



**Question 1 for the AUASB:**  
**Does AUASB have concerns/views on the stated principles and objectives?**



# Format of the ISA for LCE



Part 1 - fundamental concepts and overarching principles to be applied throughout the audit.



Part 2 - general requirements for audit evidence and documentation, as well as the overall objective of the audit.



Part 3 - the auditor's and engagement partner's obligations and responsibilities for quality management in an audit of an LCE.



Parts 4 to 9 - follows the flow of an audit engagement, set out the detailed requirements for the audit. Each have section on specific communication and documentation requirements.



# Authority of the standard

## Specific Restrictions

- Law or regulation
- Listed entity
- PIE (modified in local jurisdictions)
- Group financial statements

## Legislative authorities or relevant local bodies

- Can further limit / modify (PIE only)

## Firms and practitioners on specific engagements

- Policies and procedures and qualitative characteristics



# Qualitative characteristics of complexity

Considerations include:

- Business activities/business model/industry
- Organisational, ownership or oversight structures
- Regulation or regulatory oversight
- Complex transactions
- Complex IT systems/environment
- Complex accounting estimates – high degree of estimation uncertainty / complex methods

*Note: Supplemental Guidance will be issued along with the ED*

**Question 2 for the AUASB:**

**Does the AUASB have any concerns/views on the Authority of the standard?**



# Areas to highlight

## ***Question 3 for the AUASB:***

**Does the AUASB have any concerns or views on the areas above or the parts of the standard?**



Name of standard / where this falls within the ISAs

(Changes to the preface)



Group Audits



Definitions



Essential explanatory material – limited/judgement, sufficient for the standard to stand-alone



Maintenance



Basis of reporting – opinion to state in accordance with ISA for LCE

# ISA requirements into ISA for LCE

- Every ISA requirement has been mapped into LCE standard – over 500 pages of mapping documents
  - Requirements ‘as is’; or
  - Entire ISA omitted (ISA 600, ISA 610, ISA 701)
  - Specific requirements omitted
    - Entities excluded e.g listed or group audits
    - Complex matters / circumstances
  - Wording modified – similar outcome



# Australian considerations

- Initial discussions November 2020: AUASB, ASIC, APESB, professional bodies, ACNC as to what might this standard mean for Australia, issues raised:
  - Applicability within Australia and how this may work/be legislated?
  - Legislation refers to the AUASB Standards – which standards?
  - Charities not under the Corporations Act?
  - Voluntary audits under the AUASB Standards – which standards?
  - Other comments/considerations?

***Australian considerations this topic is to be further discussed at the AUASB Strategic session on 8 June 2021***



# Way Forward

- Expect ED to be released mid July
- Expect responses due to IAASB mid January
- Initial discussion with AUASB at September 2021 meeting as to outreach/initial thoughts
- Outreach anticipated September – November 2021
- First draft response to AUASB December 2021 meeting
- AUASB outreach plan to be determined in consultation with AUASB Chair, AUASB TD and ATG – AUASB input valued

## ***Question 4 for the AUASB:***

**Does the AUASB have any comments on the expected timing and any input into outreach?**



# Draft International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE)

(June 2021)

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International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE), should be read in the context of the *Preface to the International Quality Management, Auditing, Review, Other Assurance and Related Services Pronouncements*.

## Preface–ISA for LCE

- P.1. This standard (i.e., the ISA for LCE) has been designed to apply to audits of financial statements of less complex entities (LCEs) in the private and public sectors. The standard has been developed based on the concepts in the International Standards on Auditing (ISAs) but designed to reflect the nature and circumstances of an audit of an LCE and result in a high-quality audit.
- P.2. Part A sets out the authority for this standard. A clear description of the type of audit for which this standard has been designed - as set out in Part A - is essential so that:
- The IAASB can decide on and design objectives and requirements that are appropriate for an audit of an LCE and therefore should be included within the ISA for LCE; and
  - Legislative authorities or relevant local bodies, firms, auditors, and others will be informed of the intended scope of the standard.
- P.3. Some jurisdictions may have developed local descriptions to prescribe financial reporting or auditing obligations, which may or may not align with the limitations for use as set out in Part A. The intended scope of this standard corresponds to the matters describing an audit of the financial statements of an LCE as set out in Part A and does not contemplate jurisdictional descriptions.
- P.4. If this standard is used for audit engagements other than those contemplated in Part A, the auditor is not permitted to represent compliance with the ISA for LCE in the auditor's report.
- P.5. This standard does not override local law or regulation that govern audits of financial statements in a particular jurisdiction.

### The Applicable Financial Reporting Framework

- P.6. Law or regulation may establish the responsibilities of management, and where appropriate, those charged with governance in relation to financial reporting.
- P.7. The financial statements subject to audit are those of the entity, prepared by management of the entity with oversight from those charged with governance. This standard does not impose responsibilities on management or those charged with governance and does not override law or regulation that govern their responsibilities. However, an audit in accordance with this standard is conducted on the premise that management, and where appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

#### *Management's Responsibilities for Preparation of the Financial Statements*

*Law or regulation may establish the responsibilities of management, and where appropriate, those charged with governance, in relation to financial reporting. The extent of these responsibilities, or the way that they are described, may differ across jurisdictions. While there may be differences in the extent of those responsibilities or how they are described, an audit in accordance with this standard is conducted on the premise that management, and where appropriate, those charged with governance, have acknowledged and understood that they have responsibility:*

- *For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant, their fair presentation;*

- *For such internal control as management, and where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and*
- *To provide the auditor with unrestricted access to all information of which they are aware that is relevant to the preparation of the financial statements, and persons within the entity from whom the auditor determines it necessary to obtain audit evidence.*

- P.8. The applicable financial reporting framework often encompasses financial reporting standards established by an authorized or recognized standard setting organization, or legislative or regulatory requirements. In some cases, the financial reporting framework may encompass both financial reporting standards established by an authorized or recognized standard-setting organization and legislative or regulatory requirements.
- P.9. The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficient broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework.
- P.10. Some financial reporting frameworks are fair presentation frameworks, while others are compliance frameworks. This standard covers both frameworks. The term “fair presentation framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:
- (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
  - (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.

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.

### **Inherent Limitations of an Audit**

*The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive in nature. The inherent limitations of an audit arise from:*

- *The nature of financial reporting frameworks;*
- *The nature of audit procedures; and*
- *The need for audits to be conducted within a reasonable time and at a reasonable cost.*

*There are also practical and legal limitations on the auditor's ability to obtain audit evidence. For example:*

- *Not all relevant information may be provided to the auditor, either intentionally or unintentionally. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.*
- *Fraud may be occurring via schemes designed to conceal it, and audit procedures may not always be effective for detecting it. For example, an intentional misstatement that involves collusion to falsify documentation may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.*
- *An audit is not an official investigation into alleged wrongdoing and accordingly, the auditor is not given specific legal authority, such as the powers of search.*

*Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with this standard. Accordingly, the subsequent discovery of a material misstatement resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with this standard. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence.*

## **Format of the ISA for LCE**

P.11. The ISA for LCE has been presented in Parts:

- Part 1 sets out the fundamental concepts and overarching principles to be applied throughout the audit.
- Part 2 sets out the general requirements for audit evidence and documentation, as well as the overall objective of the audit.
- Part 3 sets out the auditor's and engagement partner's obligations and responsibilities for quality management in an audit of an LCE.
- Parts 4 to 9, which follows the flow of an audit engagement, set out the detailed requirements for the audit. Each of these Parts also includes specific communication and documentation requirements as necessary.

P.12. The content of each Part includes:

- Introductory material in a separate box setting out the content and scope of that Part (but does not create any additional obligations for the auditor).
- Objective(s), which link the requirements of that Part and the overall objective of the audit.
- Requirements to be met, except where the requirement is conditional and the condition does not exist. All requirements are numbered relating to the relevant Part, for example A.1., A.2., or 1.1.1., 1.1.2., etc. Requirements are expressed using "shall."
- Essential explanatory material (EEM), designed to provide further explanation relevant to a sub-section or a specific requirement. All EEM is presented in italics within separate blue boxes

and does not impose additional obligations on the auditor. There are two types of EEM: general introductory EEM that explains the context of the section that follows and EEM specific to the requirement directly above it.

- P.13. Definitions, describing the meanings attributed to certain terms for the purpose of this standard, can be found in Appendix 1.<sup>1</sup> The definitions assist in the consistent application and interpretation of the requirements, and are not intended to override definitions that may be established for other purposes, whether in law or regulation. Unless otherwise indicated, the definitions carry the same meanings throughout this standard.
- P.14. The entire text of this [draft] ISA for LCE is relevant to an understanding of the objective of this standard and the proper application of the requirements.

#### *Non-Authoritative Support Materials*

- P.15. The IAASB may issue Staff publications or other non-authoritative material to support the implementation of the ISA for LCE.

#### **Maintenance of the ISA for LCE**

- P.16. The IAASB expects to propose amendments to the ISA for LCE periodically, but not more frequently than once every three years. In developing the exposure draft of the changes, the IAASB will consider new and revised ISAs as well as specific issues that have been brought to the attention of the IAASB regarding application of the ISA for LCE. The IAASB expects that there will be a period of at least eighteen months between when amendments to the ISA for LCE are issued and the effective date of those amendments. If a change is needed between the periodic amendments, the IAASB will use the process for narrow scope maintenance of standards as set out in its Framework for Activities to make such a change.
- P.17. Until the ISA for LCE is amended, changes made or proposed to the ISAs do not apply to the ISA for LCE. Although developed having regard to the ISAs, the ISA for LCE is independent of the ISAs. Users of the ISA for LCE should not anticipate or apply changes made in the ISAs before the changes are incorporated in the ISA for LCE.

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<sup>1</sup> The definitions in this standard are consistent with the definitions in the ISAs (i.e., contained in the IAASB's Glossary of Terms within the IAASB's Handbook Volume 1).

## **A. Authority of the [Draft] ISA for Audits of Financial Statements of Less Complex Entities**

- A.1. The requirements in this [draft] ISA for LCE have been designed to be proportionate to the likely nature and circumstance of an audit of an LCE, and do not address complex matters or circumstances. This Authority [Part A] describes when the [draft] ISA for LCE is not appropriate for an audit of financial statements through describing the limitations on use. This Authority may also be used to assist the decisions by:
- Legislative authorities or relevant local bodies with standard-setting authority for adopting the [draft] ISA for LCE in an individual jurisdiction; and
  - Firms and practitioners when developing policies or procedures for use of the [draft] ISA for LCE or for use on a specific engagement.
- A.2. This [draft] ISA for LCE is not permitted to be used for audits that are not audits of LCEs. If the [draft] ISA for LCE is used for an audit outside the intended scope of this standard, compliance with the requirements of the [draft] ISA for LCE may not be sufficient for the auditor to obtain sufficient appropriate audit evidence to support a reasonable assurance opinion.

### **Limitations for Using the [Draft] ISA for LCE**

- A.3. The limitations for using the [draft] ISA for LCE sets out for which entities the use of the standard is restricted and qualitative characteristics that can be used to understand the intended scope of the standard.
- A.4. The *Supplemental Guidance for the Authority of the Standard* (the Supplemental Guide) discusses further matters that may be relevant in the determination of use of the [draft] ISA for LCE. This guidance may be helpful to legislative authorities or relevant local bodies with standard-setting authority when determining the permitted use of the standard. The Supplemental Guide may also be helpful to firms in developing policies or procedures in relation to the use of the [draft] ISA for LCE. At the engagement level, the engagement partner may also find the guidance helpful in understanding when the standard would be appropriate for a particular audit engagement.

### *Basis for the Limitations*

- A.5. The limitations for use described in this standard are based on the following overarching principles:
- Entities that have public interest characteristics have been excluded.
  - Complex matters or circumstances relating to the nature and extent of the entity's business activities, operations and related transactions and events relevant to the preparation of the financial statements, are excluded.
  - Topics, themes and matters that increase, or indicate the presence of, complexity have been excluded, such as relating to ownership, corporate governance arrangements, policies, procedures or processes established by the entity.

### *Specific Restrictions*

- A.6. The following list of restrictions sets out the classes of entities for which the use of this standard is specifically restricted. This list may only be modified for those classes indicated as being able to be

modified, as explained below, by legislative authorities or relevant local bodies with standard-setting authority.

A.7. The [draft] ISA for LCE shall not be used if:

- (a) Law or regulation:
  - (i) Prohibits the use of the [draft] ISA for LCE; or
  - (ii) Specifies auditing standards other than the [draft] ISA for LCE for an audit of financial statements in that jurisdiction.
- (b) The entity is a listed entity.
- (c) An entity meets one of the following criteria:<sup>2</sup>
  - (i) An entity one of whose main functions is to take deposits from the public;
  - (ii) An entity one of whose main functions is to provide insurance to the public;
  - (iii) An entity whose function is to provide post-employment benefits;
  - (iv) An entity whose function is to act as a collective investment vehicle and which issues redeemable financial instruments to the public; or
  - (v) An entity is specified as not able to use the [draft] ISA for LCE by law or regulation.
- (d) The audit is an audit of group financial statements.<sup>3</sup>

The restrictions in paragraph A.7. (a), (b) and (d) are outright restrictions and cannot be changed.

Each category of restricted entity in paragraph A.7. (c)) can be modified in a jurisdiction by the legislative authority or relevant local body as appropriate, for example through a quantitative criteria or another category of entity can be added in paragraph A.7.(c)(v). However, a category cannot be removed.

#### Firms Policies or Procedures

A.8. In setting policies or procedures for a firm's use of the [draft] ISA for LCE, firms may further restrict the types of entities that can use the [draft] ISA for LCE, while having regard to the list in paragraph A.7. (a) to (e) above (that cannot be changed at the firm level).

#### Qualitative Characteristics

A.9. If the use of the standard is not restricted as explained above, determining whether the [draft] ISA for LCE is appropriate for an audit of financial statements is a matter of professional judgment and based on the nature and circumstances of the entity being audited. The qualitative characteristics are indicators of, or proxies for, matters or circumstances for which the standard has not been designed. Each of the qualitative characteristics may on its own not be sufficient to determine whether the

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<sup>2</sup> The criteria set out in (c) align with the proposals by the International Ethics Standards Board for Accountants (IESBA) to describe a public interest entity – if further changes are made by the IESBA further consideration will be given to the appropriateness of this list for the purpose of the authority of the [draft] ISA for LCE.

<sup>3</sup> Group financial statements are financial statements that include the financial information of more than one entity or business unit through a consolidation process.

standard is appropriate or not in the circumstances, therefore the matters described in the list are intended to be considered individually and in combination.

A.10. The [draft] ISA for LCE may not be appropriate for the audit of the financial statements if the entity exhibits one or more of the following characteristics:

- The entity's business activities, business model or the industry in which the entity operates results in pervasive risks that increase the complexity of the audit, such as when the entity operates with high-risk products or services.
- The organizational structure is not relatively straightforward or simple, such as
  - Multiple levels and reporting lines, with many individuals involved in financial reporting, to accommodate the entity's business activities; or
  - Including unusual entities or arrangements, such as special-purpose entities, joint ventures, off-balance sheet financing arrangements, or other complex financing arrangements.
- Ownership or oversight structures are complex, such as where there are multiple owners or where the governance structures are multifaceted.
- The entity's operations are subject to a high degree of complex regulation or to significant regulatory oversight, such as being subject to prudential regulations.
- Transactions are complex or the information system and related processes relevant to the entity's financial statements are complex such that the data collection and processing involves complex accounting or calculations.
- Where the entity's IT environment or IT systems are complex, such as when the IT environment and processes involve highly-customized or highly-integrated IT applications, with internal resources or external service providers that have software development and IT environment maintenance skills to support the IT environment and processes
- Where the entity's accounting estimates are subject to a high degree of estimation uncertainty or the measurement basis requires complex methods that may involve multiple sources of historical and forward-looking data or assumptions, with multiple interrelationships between them.

This list is not exhaustive and other relevant matters may also need to be considered.

### **Responsibilities of Legislative Authorities or Relevant Local Bodies**

A11. Decisions about the required or permitted use of the IAASB's International Standards rest with legislative authorities or relevant local bodies with standard-setting authority (such as regulators or oversight bodies, national standard setters, professional accountancy organizations or others as appropriate) in individual jurisdictions. This applies to the International Standards on Auditing (ISAs) and the [draft] ISA for LCE.

A.12. As part of the local adoption and implementation process, legislative authorities or relevant local bodies may modify aspects of the limitations specified in paragraph A.7 (c), or further limit use by setting specific size criteria or further restricting the use to other types of entities. In doing so, the

specific restrictions and the qualitative characteristics should be considered, as well as other specific needs that may be relevant in the jurisdiction.

### **Firms and Practitioners**

- A.13. Firms are responsible for establishing policies or procedures in relation to the permitted use of the [draft] ISA for LCE by the firm's engagement teams. In deciding about the firm's permitted use of this standard for audits of LCE's, the firm is required to have regard to the matters set out in paragraph A.8. in relation to the specifically restricted categories of entities, as well as the qualitative characteristic described in paragraphs A.9.–A.10.
- A.14. For specific engagements, the engagement partner is required to determine that the audit engagement is an audit of a LCE in accordance with this Part (i.e., Part A) in order to use the [draft] ISA for LCE when accepting or continuing an engagement (see Part 4, paragraph 4.2.1.). For this purpose, the engagement partner has regard to:
- The list of entities for which the use of the standard is specifically restricted as set out in the local jurisdiction (see paragraph A.7.) as well as the firm's policies or procedures; and
  - The qualitative characteristics (see paragraphs A.9.–A.10).

## 1. **Fundamental Concepts and General Principles**

### *Content of this Part*

Part 1 sets out the:

- Effective date of this standard.
- The requirements for relevant ethical requirements and obligations for firm-level quality management.
- Overall objectives of the auditor. Each Part within this standard contains an objective for planning and performing the audit and provides a link between the requirements within that Part and the overall objectives of the auditor. The objectives within each Part assist the auditor to understand the intended outcomes of the procedures contained in that Part.
- Fundamental concepts and general principles applicable to the engagement, including for professional skepticism and professional judgment.
- Overarching requirements in relation to fraud, law or regulation, related parties and communications with management and, where appropriate, those charged with governance.
- General communication requirements that apply to all Parts. Within individual Parts there may be additional specific communication requirements

### *Scope of this Part*

The concepts and principles in this part apply throughout the audit engagement. .

### 1.1. **Effective Date**

1.1.1. This standard is effective for audits of financial statements for periods beginning on or after [XXX].

*The auditor is permitted to apply this standard, if not prohibited by law or regulation, before the effective date specified.*

### 1.2. **Relevant Ethical Requirements and Firm-Level Quality Management**

#### *Relevant Ethical Requirements for an Audit of Financial Statements*

1.2.1. The auditor shall comply with relevant ethical requirements, including those pertaining to independence, for financial statement audit engagements.

*Relevant ethical requirements ordinarily comprise the International Ethics Standards Board for Accountants' (IESBA's) International Code of Ethics for Professional Accountants (including International Independence Standards) (Code of Ethics) related to an audit of financial statements together with national requirements that are more restrictive.*

## Firm Quality Management

*Systems of quality management, including the policies or procedures are the responsibility of the firm. ISQM 1,<sup>4</sup> applies to all firms that perform audits. This standard is premised on the basis that the firm is subject to ISQM 1 or to national requirements that are at least as demanding.*

*If an engagement quality review is required by the firm's policies or procedures established in accordance with ISQM 1, then ISQM 2,<sup>5</sup> applies. ISQM 2 deals with the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review.*

### 1.3. Overall Objectives of the Auditor

1.3.1. The overall objectives of the auditor when conducting an audit of financial statements using the ISA for LCE are to:

- (a) Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, to enable the auditor to express an opinion on whether the financial statements are prepared, in all material respects in accordance with an applicable financial reporting framework; and
- (b) Report on the financial statements, and communicate as required by the ISA for LCE, in accordance with the auditor's findings.

#### *Reasonable Assurance*

*As the basis for the auditor's opinion, this standard requires the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit.*

*Audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.*

1.3.2. To achieve the overall objectives, the auditor shall use the objectives stated in the relevant Parts in planning and performing the audit, to:

- (a) Determine whether any audit procedures in addition to those required by the relevant Part are necessary in pursuance of the objectives stated in this standard; and
- (b) Evaluate whether sufficient appropriate audit evidence has been obtained.

1.3.3. If an objective in a Part cannot be achieved by performing the procedures required by the Part and other procedures considered necessary in the circumstances, the auditor shall evaluate whether this

<sup>4</sup> International Standards on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews for Financial Statements, or Other Assurance or Related Services Engagements*

<sup>5</sup> ISQM 2, *Engagement Quality Reviews*

prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor to modify the auditor's opinion or withdraw from the engagement (where withdrawal is possible under applicable law or regulation). Failure to achieve an objective represents a significant matter requiring documentation.

- 1.3.4. Because the circumstances of audit engagements vary and all circumstances cannot be anticipated, the auditor shall determine whether procedures in addition to those required by this standard are required to achieve the objectives in each Part.

*The auditor is required to use the objectives to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If as a result the auditor concludes that the audit evidence is not sufficient and appropriate, then the auditor may follow one or more of the following approaches:*

- *Evaluate whether further relevant audit evidence has been, or will be, obtained;*
- *Extend the work performed in applying one or more requirements; or*
- *Perform other procedures judged by the auditor to be necessary in the circumstances.*

#### **1.4. Fundamental Concepts and General Principles for Performing the Audit**

- 1.4.1. When an audit is performed in accordance with this standard, the auditor shall comply with all relevant requirements (unless paragraph 1.4.3. applies). A requirement is relevant when the circumstances of the audit addressed by the requirement exist.
- 1.4.2. The auditor shall not represent compliance with the [draft] ISA for LCE in the auditor's report unless all relevant requirements in this standard have been met.
- 1.4.3. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement. In such circumstances, the auditor shall perform alternative procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement.
- 1.4.4. The auditor shall have an understanding of the entire text of this standard to understand its objectives and apply its requirements properly.

#### *Professional Judgment*

- 1.4.5. The auditor shall exercise professional judgment in planning and performing the audit.

*Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and this standard and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances.*

*The distinguishing feature of the professional judgment expected of an auditor is that it is exercised by an auditor whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable judgments (i.e., the professional judgment reached reflects a competent application of auditing and accounting principles and is appropriate in the circumstances).*

*The exercise of professional judgment in any particular case is based on the facts and circumstances that are known to the auditor.*

*Professional judgment is required to be documented in accordance with the requirements of Part 2 of this standard.*

### *Professional Skepticism*

1.4.6. The auditor shall plan and perform the audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.

1.4.7. The auditor shall design and perform procedures in a way that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that is contradictory.

*Professional skepticism includes being alert to, for example:*

- *Audit evidence that contradicts other audit evidence obtained.*
- *Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.*
- *Conditions that may indicate possible fraud.*
- *Circumstances that suggest the need for audit procedures in addition to those required by this standard.*

*Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management, and where appropriate, those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances.*

*The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management, and where appropriate, those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance.*

## **1.5. Fraud**

*The primary responsibility for the prevention and detection of fraud rests with both management, and where appropriate, those charged with governance of the entity. Although fraud is a broad legal concept, for the purposes of this standard, the auditor is concerned with fraud that causes a material misstatement in the financial statements.*

*An auditor conducting an audit in accordance with this standard is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error even though the audit is properly planned and performed in accordance with this standard. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor.*

*When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this standard are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.*

1.5.1. The auditor shall consider fraud when:

- (a) Identifying and assessing risks of material misstatement. In doing so, the auditor shall evaluate whether information obtained from the procedures to identify and assess risks and related activities indicates that one or more fraud risk factors are present;<sup>6</sup>
- (b) Obtaining sufficient appropriate audit evidence through designing and implementing appropriate responses to assessed risks of material misstatement; and
- (c) Responding appropriately to fraud or suspected fraud identified during the audit.

*Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.*

*Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.*

#### *Considerations Specific to Public Sector Entities*

*The public sector auditor's responsibilities relating to fraud may be a result of law, regulation or other authority applicable to public sector entities or separately covered by the auditor's mandate. Consequently, the public sector auditor's responsibilities may not be limited to consideration of risks of material misstatement of the financial statements, but may also include a broader responsibility to consider risks of fraud.*

#### *Auditor Unable to Continue the Engagement*

1.5.2. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall determine the legal and professional responsibilities applicable in the circumstances or consider whether it is appropriate to withdraw, where withdrawal is possible under law or regulation.

#### *Considerations Specific to Public Sector Entities*

*In many cases in the public sector, the option of withdrawing from the engagement may not be available to the auditor due to the nature of the mandate or public interest considerations.*

<sup>6</sup> Appendix 3 sets out fraud risk factors relevant to less complex entities.

## 1.6. Law or Regulation

*It is the responsibility of management, with the oversight of those charged with governance where appropriate, to ensure that the entity's operations are conducted in accordance with the provisions of law or regulation, including compliance with the provisions of law or regulation that determine the reported amounts and disclosures in an entity's financial statements.*

*The requirements in this standard are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with law or regulation. However, the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all law or regulation. The auditor's responsibilities in relation to compliance with two different categories of law or regulation are distinguished as follows:*

- (a) The provisions of those laws or regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements (e.g., tax and pension law or regulation); and*
- (b) Other law or regulation that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (e.g., compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations), i.e., non-compliance with such law or regulation may therefore have a material effect on the financial statements*

- 1.6.1. During the audit, the auditor shall remain alert to the possibility that performing audit procedures may bring instances of non-compliance or suspected non-compliance with law or regulation to the auditor's attention.

### *Considerations Specific to Public Sector Entities*

*In the public sector, there may be additional audit responsibilities with respect to the consideration of laws and regulations which may relate to the audit of financial statements or may extend to other aspects of the entity's operations.*

- 1.6.2. In the absence of identified or suspected non-compliance with law or regulation, the auditor is not required to perform audit procedures regarding the entity's compliance with law or regulations, other than what is required by this standard.

- 1.6.3. If the auditor has identified or suspects non-compliance with law or regulation, the auditor shall determine whether law, regulation or relevant ethical requirements:

- (a) Require the auditor to report to an appropriate authority outside the entity.
- (b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.

*Reporting identified or suspected non-compliance with law or regulation to an appropriate authority outside the entity may be required or appropriate in the circumstances because:*

- The auditor has determined reporting is an appropriate action to respond to identified or suspected non-compliance in accordance with relevant ethical requirements; or*
- Law, regulation or relevant ethical requirements provide the auditor with the right to do so.*

## 1.7. Related Parties

1.7.1. During the audit, the auditor shall remain alert for:

- (a) Information about the entity's related parties, including circumstances involving a related party with dominant influence; and
- (b) Arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, and significant transactions outside the entity's normal course of business.

*Many related party transactions occur in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.*

*The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the framework, regardless of whether the applicable financial reporting framework has established specific accounting or disclosure requirements for related party information.*

## 1.8. General Communications with Management and Those Charged with Governance

1.8.1. The auditor shall communicate, on a timely basis, with management and those charged with governance, if separate.

*Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. Governance is the collective responsibility of a governing body, such as a board of directors, a supervisory board, partners, proprietors, a committee of management, a council of governors, trustees or equivalent.*

*If those charged with governance are separate from management, the communication requirements to those charged with governance also apply to management, and therefore the auditor is required to communicate with both.*

*There may be other cases where it is not clear with whom to communicate, for example in some family owned businesses, some not-for-profit organizations and some government entities (e.g., the governance structure may not be defined). In such cases the auditor may need to discuss and agree with whom communications should be made.*

1.8.2. Specific matters to be communicated are required throughout this standard. The auditor shall use professional judgment in determining the appropriate form, timing and general content of the communications with management, and when appropriate, those charged with governance. When determining the form of communication, the auditor shall consider:

- (a) Legal requirements for communication; and
- (b) The significance of the matters to be communicated.

*The appropriate timing for communications will vary with the circumstances of the audit, and may be affected by the significance and nature of the matter, and the actions expected to be taken by those charged with governance.*

- 1.8.3. In some cases, all of those charged with governance are involved in managing the entity, for example, an LCE where a single owner manages the entity and no one else has a governance role. In these cases, if matters required by this standard are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be communicated again with those same person(s) in their governance role. The auditor shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.
- 1.8.4. Where responses to inquiries of management, and where appropriate, those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.
- 1.8.5. If the auditor has identified fraud or has obtained information that indicates that fraud may exist, the auditor shall communicate these matters, unless prohibited by law or regulation, on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.

*Considerations Specific to Public Sector Entities*

*In the public sector, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law, regulation or other authority.*

*Specific Communications to Those Charged with Governance in Relation to Fraud*

- 1.8.6. Unless prohibited by law or regulation, the auditor shall communicate to those charged with governance, on a timely basis, if the auditor has identified or suspects fraud involving:
- (a) Management;
  - (b) Employees who have significant roles in the entity's internal control system; or
  - (c) Others where the fraud results in a material misstatement in the financial statements.
- 1.8.7. If the auditor suspects fraud involving management, the auditor shall communicate these suspicions to those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit.

**1.9. Public Sector Entities**

- 1.9.1. This standard is relevant to engagements in the public sector if the criteria set out in the Authority in Part A have been met. The public sector auditor's responsibilities, however, may be affected by the audit mandate, or by obligations on public sector entities arising from law, regulation or other authority (such as ministerial directives, government policy requirements, or resolutions of the legislature), which may encompass a broader scope than an audit of financial statements in accordance with this standard. These additional responsibilities are not dealt with in this standard. They may be dealt with in the pronouncements of the International Organization of Supreme Audit Institutions or national standard setters, or in guidance developed by government audit agencies.

- 1.9.2. The applicable financial reporting framework in a public sector entity is determined by the legislative and regulatory frameworks relevant to each jurisdiction or within each geographical area. Matters that may be considered in the entity's application of the applicable financial reporting requirements, and how it applies in the context of the nature and circumstances of the entity and its environment, include whether the entity applies a full accrual basis of accounting or a cash basis of accounting in accordance with the International Public Sector Accounting Standards, or a hybrid.
- 1.9.3. 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 made outside of the entity as a result of political processes. Therefore, management may not have control over certain decisions that are made. Matters that may be relevant include understanding the ability of the entity to make unilateral decisions, and the ability of other public sector entities to control or influence the entity's mandate and strategic direction.
- 1.9.4. Where relevant, considerations specific to public sector entities have been included in EEM.

### 1.10. Automated Tools and Techniques

*In applying this standard, an auditor may design and perform audit procedures manually or through the use of automated tools and techniques (ATT), and either technique can be effective. Regardless of the tools and techniques used, the auditor is required to comply with the requirements in this standard.*

*(ATT, for the purpose this standard, are IT-enabled processes that involve the automation of methods and procedures, including the analysis of data using modelling and visualization, robotic process automation, artificial intelligence and machine learning, and drone technology to observe or inspect assets. Using such ATT can supplement or replace manual or repetitive tasks. Examples of ATT that may be used to perform procedures include:*

- *Data analytics—used to evaluate entire data sets by discovering and analyzing patterns and trends, identifying and investigating unusual items, deviations and anomalies, through the use of, for example, predictive analytics. The auditor may also obtain other useful information from large data sets relevant to the identification and assessment of risks of material misstatement that may not have been as easily visible or obvious through the use of more traditional tools or techniques.*
- *Robotic process automation —the processing of structured data by using a software that automates activities that humans perform, typically repetitive tasks that require minimal judgment.*
- *Artificial intelligence techniques—machine learning technology trained to recognize patterns in vast volumes of data, including unstructured data such as emails, social media, contracts, invoices, images and conference call video and audio files.*

*The use of ATT may potentially create biases or a general risk of overreliance on the information or output of the audit procedure performed. As powerful as these tools may be, they are not a substitute for the auditor's knowledge and professional judgment. Further, although the auditor may have access to a wide array of data, including from varying sources (i.e., increased quantity), the exercise of professional skepticism remains necessary to critically assess both the quality and reliability of the data as well as the outputs from using ATT.*

## 2. Audit Evidence and Documentation

### *Content of this Part*

Part 2 sets out the requirements to be applied throughout the audit for:

- Audit evidence.
- Documentation. This Part also sets out the general documentation requirements for all Parts. Within individual Parts there may also be additional specific documentation requirements.

### *Scope of this Part*

The requirements in this Part apply throughout the audit engagement when using this standard.

### 2.1. Objectives

2.1.1. The objectives of the auditor are to:

- (a) Design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion; and
- (b) Prepare documentation that provides a sufficient and appropriate record of the basis for the auditor's report and provides evidence that the audit was planned and performed in accordance with the ISA for LCE and applicable law or regulation.

### 2.2. Sufficient Appropriate Audit Evidence

2.2.1. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level thereby enabling the auditor to draw reasonable conclusions on which to base the auditor's opinion.

2.2.2. The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

*Sufficiency is the measure of the quantity of audit evidence, and is affected by the auditor's assessment of the risks of material misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also the quality of the audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate if it is of poor quality.*

*Appropriateness is the measure of the quality of the audit evidence, that is its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of audit evidence is influenced by its source and by its nature, and dependent on the individual circumstances under which it is obtained.*

*Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment.*

### 2.3. Information to be Used as Audit Evidence

*Audit evidence is cumulative in nature and is primarily obtained from audit procedures performed during the audit, but may also include information from other sources, such as:*

- *Previous audits (provided that the auditor has confirmed there are no changes);*
- *Other engagement performed for the client; and*
- *The firm's quality management procedures for acceptance and continuance.*

*Audit evidence may come from inside or outside the entity (the entity's accounting records are an important source of audit evidence), the work of management's expert, and includes information that both supports and corroborates management's assertions, as well as contradicts such assertions.*

2.3.1. When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence, including from external information sources.

*Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. The relevance of the information may be affected by the direction of testing.*

*The reliability of information to be used as audit evidence is influenced by its source and nature, as well as the circumstances under which it was obtained, including the controls over its preparation and maintenance where relevant. Generally, the reliability of information is increased when it is obtained from independent sources outside of the entity, by the auditor directly, is an original document rather than a copy and written rather than oral information. However, circumstances may exist that could affect these generalizations.*

2.3.2. When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes including, as necessary in the circumstances:

- (a) Obtaining evidence about the accuracy and completeness of the information; and
- (b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes.

*Obtaining audit evidence about the accuracy and completeness of such information may be performed concurrently with the actual audit procedure applied to the information when obtaining such audit evidence is an integral part of the audit procedure itself. In other situations, the auditor may have obtained audit evidence of the accuracy and completeness of such information by testing controls over the preparation and maintenance of the information. In some situations, however, the auditor may determine that additional audit procedures are needed.*

2.3.3. Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further and determine the effect on the rest of the audit evidence obtained.

2.3.4. The auditor shall determine what modifications or additions to procedures are necessary if:

- (a) Audit evidence obtained from one source is inconsistent with that obtained from another; or
- (b) The auditor has doubts about the reliability of information to be used as audit evidence.

## 2.4. Procedures for Obtaining Audit Evidence

*Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by designing and performing procedures to identify and assess risks of material misstatement (see Part 6) and further audit procedures (see Part 7).*

*Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.*

### *Automated Tools and Techniques*

*In applying this standard, an auditor may design and perform audit procedures manually or through the use of ATT, and either technique can be effective. Regardless of the tools and techniques used, the auditor is required to comply with this standard. In certain circumstances, when obtaining audit evidence, an auditor may determine that the use of ATT to perform certain audit procedures may result in more persuasive audit evidence relative to the assertion being tested. In other circumstances, performing audit procedures may be effective without the use of ATT.*

## 2.5. General Documentation Requirements

### *Automated Tools and Techniques*

*This standard does not differentiate between different tools and techniques that the auditor may use to design and perform audit procedures, for example using manual or automated audit procedures with respect to what is required to be documented. Regardless of the tools and techniques used, the auditor is required to comply with relevant documentation requirements.*

2.5.1. Specific matters to be documented are set out throughout this standard. The auditor shall prepare audit documentation on a timely basis that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

- (a) The nature, timing and extent of the audit procedures performed in accordance with this standard and applicable legal and regulatory requirements, including recording:
  - (i) The identifying characteristics of the specific items or matters tested;
  - (ii) Who performed the work and the date such work was completed;
  - (iii) Who reviewed the audit work performed and the date and extent of such review, including what was reviewed;
- (b) The results of the audit procedures performed, and the audit evidence obtained; and
- (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

*Judging the significance of a matter requires professional judgment and the analysis of the facts and circumstances. Example of significant matters may include matters giving rise to significant risks, areas where the financial statements could be materially misstated, circumstances where the auditor has had difficulty in applying the necessary audit procedures, or any findings that could result in a modified opinion.*

*The form, content and extent of audit documentation depends on the nature and circumstances of the entity and the procedures being performed. Audit documentation may be in paper or electronic format. It is not necessary to include superseded drafts of working papers or financial statements in the audit documentation. Oral explanations, by the auditor on their own, do not adequately support the work performed by the auditor or the conclusions reached.*

*The audit documentation for the audit of a less complex entity is generally less extensive than that for the audit of a more complex entity. Further, in the case of an audit where the engagement partner performs all the audit work, the documentation will not include matters that might have to be documented solely to inform or instruct members of an engagement team, or to provide evidence of review by other members of the team (for example, there will be no matters to document relating to team discussions or supervision). Nevertheless, the engagement partner complies with the overriding requirement to prepare audit documentation that can be understood by an experienced auditor, as the audit documentation may be subject to review by external parties for regulatory or other purposes.*

- 2.5.2. If the auditor identified information that is inconsistent with the auditor's conclusion regarding a significant matter, the auditor shall document how the inconsistency was addressed.
- 2.5.3. If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement of this standard, the auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure.
- 2.5.4. The auditor shall include in the audit documentation any:
- (a) Communications about fraud made to management, those charged with governance, regulators and others; and
  - (b) Discussions of significant matters related to non-compliance with law or regulation with management, those charged with governance and others, including how the matter has been responded to.

#### *Documentation of the Communications*

- 2.5.5. The auditor shall document discussions of significant matters with management, and where appropriate, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.
- 2.5.6. Where matters required to be communicated by this standard are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated.
- 2.5.7. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation. Written communications need not include all matters that arose during the audit.

### **3. Engagement Quality Management**

#### *Content of this Part*

Part 3 sets out the responsibilities for managing and achieving quality for the audit engagement.

#### *Scope of this Part*

In accordance with ISQM 1, the firm is responsible for designing, implementing and operating a system of quality management for audits of financial statements, that provides the firm with reasonable assurance that the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements, and that engagement reports issued are appropriate in the circumstances. The engagement team, led by the engagement partner, is responsible within the context of the firm's system of quality management for:

- Implementing the firm's responses to quality risks that are applicable to the audit engagement using information communicated by, or obtained from, the firm;
- Determining whether additional responses are needed at the engagement level beyond those in the firm's policies or procedures given the nature and circumstances of the engagement; and
- Communicating to the firm information from the audit engagement that is required to be communicated by the firm's policies or procedures to support the design, implementation and operation of the firm's system of quality management.

The requirements in this Part apply throughout the audit engagement using this standard.

#### **3.1. Objective**

3.1.1. The objective of the auditor is to manage quality at the engagement level to obtain reasonable assurance that quality has been achieved such that:

- (a) The auditor has fulfilled the auditor's responsibilities in accordance with this ISA for LCE, relevant ethical standards and the applicable legal and regulatory requirements; and
- (b) The auditor's report is appropriate in the circumstances.

#### **3.2. The Engagement Partner's Responsibilities**

##### *Leadership Responsibilities for Managing and Achieving Quality*

*The requirements for direction, supervision and review of the work of other members of the engagement team are only relevant if there are members of the engagement team other than the engagement partner.*

3.2.1. The engagement partner shall take overall responsibility for managing and achieving quality on the audit engagement. In doing so, the engagement partner shall be sufficiently and appropriately involved throughout the audit engagement such that the engagement partner has the basis for determining whether the significant judgments made, and conclusions reached are appropriate in the circumstances.

*Being sufficiently and appropriately involved throughout the audit engagement when procedures, tasks or actions have been assigned to other members of the engagement team may be demonstrated by the engagement partner in different ways, including:*

- *Informing assignees about the nature of their responsibilities and authority, the scope of the work being assigned and the objectives thereof; and to provide any other necessary instructions and relevant information.*
- *Direction and supervision of the assignees.*
- *Review of the assignees' work to evaluate the conclusions reached.*

3.2.2. The engagement partner shall take responsibility for clear, consistent and effective actions being taken that reflect the firm's commitment to quality, and establish and communicate the expected behavior of the engagement team members, including emphasizing:

- (a) That all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level;
- (b) The importance of professional ethics, values and attitudes to the members of the engagement team;
- (c) The importance of open and robust communication within the engagement team, and supporting the ability of engagement team members to raise concerns without fear of reprisal; and
- (d) The importance of each engagement team member exercising professional skepticism throughout the audit engagement.

*The engagement partner's responsibility for managing and achieving quality is supported by a firm culture that demonstrates a commitment to quality. In addressing the requirements in paragraphs 3.2.1. and 3.2.2. above, the engagement partner may communicate directly to other members of the engagement team and reinforce this communication through conduct and actions (e.g., leading by example). The nature, timing and extent of the actions of the engagement partner to demonstrate the firm's commitment to quality may depend on a variety factors including the size, structure, geographical dispersion and complexity of the firm and the engagement team, and the nature and circumstances of the audit engagement. With a smaller engagement team with few engagement team members, influencing the desired culture through direct interaction and conduct may be sufficient.*

3.2.3. If the engagement partner assigns the design or performance of procedures, tasks or actions to other members of the engagement team, the engagement partner shall continue to take overall responsibility for managing and achieving quality through direction and supervision of those members of the engagement team, and review of their work.

3.2.4. In taking overall responsibility for managing and achieving quality through direction, supervision and review of the work, the engagement partner shall determine that the nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the engagement and in compliance with the firm's related policies or procedures, this standard, relevant ethical requirements and regulatory requirements.

*The approach to direction, supervision and review may be tailored depending on, for example:*

- *The engagement team member's previous experience with the entity and the area to be audited.*
- *The assessed risks of material misstatement. A higher assessed risk of material misstatement may require a corresponding increase in the extent and frequency of the direction and supervision of engagement team members and a more detailed review of their work.*
- *The competence and capabilities of the individual engagement team members performing the audit work. For example, less experienced engagement team members may require more detailed instructions and more frequent, or in-person, interactions as the work is performed.*
- *The manner in which the reviews of the work performed are expected to take place. For example, in some circumstances, remote reviews may not be effective in providing the necessary direction and may need to be supplemented by in-person interactions.*

### *Relevant Ethical Requirements*

3.2.5. Throughout the audit engagement, the engagement partner shall:

- (a) Take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement and the firm's related policies or procedures for identifying, evaluating and addressing threats to compliance with relevant ethical requirements; and
- (b) Remain alert throughout the audit engagement, through observation, inspection of audit documentation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team.

3.2.6. The engagement partner shall take appropriate action, including evaluating the matter, complying with the firm's related policies or procedures and consulting with others in the firm, as appropriate if matters come to the engagement partner's attention that indicate that:

- (a) A threat to compliance with relevant ethical requirements exists; or
- (b) Relevant ethical requirements have not been fulfilled.

### *Other Engagement Partner Responsibilities*

3.2.7. Taking into account the nature and circumstances of the audit and the firm's related policies or procedures, the engagement partner shall determine that:

- (a) Sufficient and appropriate resources are assigned or made available to the engagement team in a timely manner; and
- (b) Members of the engagement team, and any auditor's external experts, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement.

3.2.8. If the conditions in paragraph 3.2.7. are not met, the engagement partner shall take appropriate action including, if relevant, communicating with appropriate individuals about the need to assign or make available additional or alternative resources to the engagement.

3.2.9. The engagement partner shall take responsibility for using the resources assigned or made available to the engagement team appropriately.

3.2.10. The engagement partner shall:

- (a) Understand the information from the firm's monitoring and remediation process that has been communicated and, if applicable, information for the monitoring and remediation process of other network firms that has been communicated, and determine the relevance and effect of that information on the audit engagement; and
- (b) Remain alert for matters that may be relevant to the firm's monitoring and remediation process, and communicate that information as appropriate.

3.2.11. The engagement partner shall review audit documentation at appropriate points in time during the audit, including documentation of significant matters, significant judgments (including those relating to difficult or contentious matters) and other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.

*The engagement partner exercises professional judgment in determining matters to review, for example, based on:*

- *The nature and circumstances of the audit engagement.*
- *Which engagement team member performed the work.*
- *Matters from recent inspection findings.*
- *The requirements of the firm's policies or procedures.*

3.2.12. On or before the date of the auditor's report, the engagement partner shall determine, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.

3.2.13. The engagement partner shall:

- (a) Take responsibility for differences of opinion being addressed and resolved in accordance with the firm's policies or procedures;
- (b) Take responsibility for consultations being made in accordance with the firm's related policies or procedures, or where deemed necessary, on difficult or contentious matters;
- (c) Determine that conclusions reached with respect to differences of opinion and difficult or contentious matters are documented and implemented; and
- (d) Not date the auditor's report until any differences of opinion are resolved.

*Forming an objective view on the appropriateness of the judgments made in the course of the audit can present practical problems when the same individual also performs the entire audit. If unusual issues are involved, it may be desirable to consult with other suitably- experienced auditors or the auditor's professional body.*

*Consultation may be appropriate, or required by the firm's policies or procedures, when there are issues that are complex or unfamiliar, significant risks, significant transactions that are outside the normal course of business, or that otherwise appear to be unusual, limitations imposed by management or non-compliance with law or regulation.*

*In considering matters related to differences of opinion, or difficult or contentious matters, the engagement partner may also consider whether the use of the ISA for LCE continues to be appropriate.*

- 3.2.14. If an engagement quality review is required, the engagement partner shall determine that an engagement quality review has been performed in accordance with the firm's related policies or procedures, and:
- (a) Discuss significant matters and significant judgments arising during the audit with the engagement quality reviewer; and
  - (b) Not date the auditor's report before the engagement quality review is complete.

*Review of Communications*

- 3.2.15. The engagement partner shall review, prior to their issuance, formal written communications to management, those charged with governance or regulatory authorities.

## **4. Acceptance or Continuance of an Audit Engagement and Initial Audit Engagements**

### *Content of this Part*

Part 4 sets out the auditor's responsibilities for:

- Agreeing the terms of the audit engagement with management, and where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit are present.
- Determining that use of the [draft] ISA for LCE is appropriate for the audit engagement.

Part 4 also addresses activities related to initial audit engagements.

### *Scope of this Part*

Part A of this standard sets out the restrictions and considerations for appropriate use of this standard. This Part sets out the auditor's obligations on the appropriate use of this standard when accepting or continuing an audit engagement.

The information and audit evidence gathered during client acceptance and continuance procedures is used to also inform the auditor's procedures when planning the audit and for the risk identification and assessment process.

Part 1.2. sets out that this standard is premised on the basis that the firm is subject to ISQM 1 or to national requirements that are at least as demanding. ISQM 1 requires the firm to establish quality objectives that address the acceptance and continuance of client relationships and specific engagements. In addition, compliance with ISQM 1 may require firms to have policies or procedures to address other matters of relevance to this Part.

Audit engagements may only be accepted when the auditor considers that relevant ethical requirements such as independence and professional competence and due care will be satisfied and the preconditions for an audit are present. In addition, the auditor considers the performance of non-assurance services for the audit client and whether these services are permissible.

### **4.1. Objectives**

4.1.1. The objectives of the auditor are:

- (a) To accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:
  - (i) Establishing whether the preconditions for an audit are present; and
  - (ii) Confirming that there is a common understanding between the auditor and management, and where appropriate, those charged with governance, of the terms of the audit engagement.
- (b) For initial audit engagements, to obtain sufficient appropriate audit evidence about whether:
  - (i) Opening balances contain misstatements that materially affect the current period's financial statements, and

- (ii) The entity's accounting policies are consistently and appropriately reflected in the opening balances.

#### **4.2. Determining that the [Draft] ISA for LCE is Appropriate for the Audit Engagement**

4.2.1. The engagement partner shall only accept or continue an audit engagement using this [draft] ISA for LCE when the auditor determines the audit engagement is an audit of an entity as contemplated in Part A.

#### **4.3. Preconditions for an Audit**

4.3.1. In order to establish whether the preconditions for an audit are present, the auditor shall:

- (a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable;
- (b) Obtain the agreement of management and where appropriate, those charged with governance, that it acknowledges and understands its responsibility:
  - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
  - (ii) For such controls as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
  - (iii) To provide the auditor with:
    - a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
    - b. Additional information that the auditor may request from management for the purpose of the audit; and
    - c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

4.3.2. If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement:

- (a) If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable; or
- (b) If the agreement of management that it acknowledges and understands its responsibility has not been obtained.

4.3.3. If management or those charged with governance impose a limitation on the scope of the auditor's work such that the auditor believes that the limitation will result in the auditor disclaiming the opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

#### 4.4. Additional Considerations in Engagement Acceptance

4.4.1. In some cases, law or regulation of the relevant jurisdiction prescribes the layout or wording of the auditor's report in a form or in terms that are significantly different from the requirements of this standard. In these circumstances, the auditor shall evaluate:

- (a) Whether users may misunderstand the assurance obtained from the audit of the financial statements and, if so,
- (b) Whether additional explanation in the auditor's report can mitigate possible misunderstanding.

4.4.2. If the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, the auditor shall not accept the audit engagement, unless required by law or regulation to do so. An audit conducted in accordance with such law or regulation does not comply with the [draft] ISA for LCE. Accordingly, the auditor shall not include any reference within the auditor's report to the audit having been conducted in accordance with this [draft] ISA for LCE.

#### 4.5. Terms of the Audit Engagement

*Performing acceptance or continuance procedures before planning commences assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the current engagement.*

*This standard requires the auditor to ascertain certain matters, upon which it is necessary for the auditor and management or, where appropriate, those charged with governance to agree, and which are in the control of the entity, prior to the auditor accepting the audit engagement.*

4.5.1. The auditor shall agree the terms of the audit engagement, in writing, with management, or where appropriate, those charged with governance, as appropriate.

*If law or regulation prescribes the responsibilities of management that are equivalent in effect to what this standard requires, the auditor may use the wording of the law or regulation to describe them in the written agreement.*

4.5.2. On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

4.5.3. The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so.

4.5.4. If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.

4.5.5. If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

4.5.6. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

- (a) Withdraw from the audit engagement where possible under applicable law or regulation; and

- (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

4.5.7. The engagement partner shall determine that the firm's policies or procedures regarding acceptance and continuance of the audit engagement have been followed and that conclusions reached in this regard are appropriate, including the appropriate use of the ISA for LCE.

#### 4.6. Initial Audit Engagements

*The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements.*

4.6.1. If the engagement is an initial audit and there has been a change in auditor, the auditor shall communicate with the predecessor auditor, in compliance with relevant ethical requirements.

4.6.2. The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that may materially affect the current period's financial statements by:

- (a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;
- (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and
- (c) Performing one or more of the following:
  - (i) Where the prior year financial statements were audited, inspecting the predecessor auditor's working papers to obtain evidence regarding the opening balances;
  - (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
  - (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

4.6.3. If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements.

4.6.4. The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and whether any changes in accounting policies have been appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

#### 4.7. Specific Communication Requirements

##### *Communications with Those Charged with Governance*

4.7.1. The auditor shall communicate the auditor's responsibilities for forming and expressing an opinion on the financial statements prepared by management, and that the auditor's responsibilities do not

relieve management or those charged with governance from their responsibilities for oversight of the preparation of the financial statements.

#### **4.8. Specific Documentation Requirements**

4.8.1. In addition to the general documentation requirements (Part 2.5.) for an audit engagement, the auditor shall include in the audit documentation matters identified, relevant discussions with personnel, and conclusions reached with respect to:

- (a) Fulfillment of responsibilities for relevant ethical requirements, including applicable independence requirements.
- (b) The acceptance and continuance of the client relationship and audit engagement.

4.8.2. The auditor shall document the determination made for using the ISA for LCE.

4.8.3. The auditor shall document changes, if any, to the determination of the use of the ISA for LCE if further information comes to the auditor's attention during the audit that may change the professional judgment made in this regard.

4.8.4. The auditor shall record in an audit engagement letter or other suitable form of written agreement:

- (a) The objective and scope of the audit of the financial statements;
- (b) The responsibilities of the auditor;
- (c) The responsibilities of management;
- (d) Identification of the applicable financial reporting framework for the preparation of the financial statements;
- (e) Reference to the expected form and content of any reports to be issued by the auditor; and
- (f) A statement that there may be circumstances in which a report may differ from its expected form and content.

4.8.5. If law or regulation prescribes in sufficient detail the terms of the audit engagement referred to in this standard, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies, and that management acknowledges and understands its responsibilities.

## 5. **Planning**

### *Content of this Part*

Part 5 sets out the auditor's responsibility to plan the audit (including holding an engagement team discussion), and the concept of materiality when planning and performing the audit.

### *Scope of this Part*

Planning is continual and is not a discrete phase of the audit but is iterative, as necessary, throughout the audit. Some requirements within this Part are linked to procedures in other Parts and may require the auditor to execute on those procedures in order to meet the requirements in this Part.

### 5.1. **Objectives**

5.1.1. The objectives of the auditor are to:

- (a) Plan the audit so that it will be performed in an effective manner; and
- (b) Apply the concept of materiality appropriately in planning and performing the audit.

### 5.2. **Planning Activities**

*The nature, timing and extent of planning activities will vary according to the nature and circumstances of the entity, the size and nature of the engagement team, the engagement team members' previous experience with the entity and any changes in circumstances that occur during the audit engagement. When an engagement is carried out by a single individual some of the requirements may not be relevant (e.g., the engagement team discussion), however consideration may still be given to the matters within the relevant paragraphs as they may still assist the auditor.*

5.2.1. The engagement partner and other key members of the engagement team shall be involved in planning the audit.

5.2.2. The auditor shall set the scope, timing and direction of the audit and:

- (a) Identify the characteristics of the engagement that define its scope;
- (b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- (c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
- (d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for this entity is relevant;
- (e) Ascertain the nature, timing and extent of resources necessary to perform the audit, including determining whether experts are needed; and
- (f) Plan the nature, timing and extent of direction and supervision of engagement members and review of their work.

*In the audit of an LCE, establishing the scope, timing and direction of the audit need not be a complicated or time-consuming exercise. For example, a suitable brief memorandum prepared at the completion of the previous audit, based on inspection of the working papers and highlighting issues identified in the audit just completed, updated in the current period based on discussions with the owner-manager, can serve as the documented scope, timing and direction for the current audit engagement. Standard audit programs or checklists drawn up on the assumption of few relevant control activities, as is likely to be the case in a smaller entity, may be used provided that they are tailored to the circumstances of the engagement, including the auditor's risk assessments.*

- 5.2.3. The auditor shall update and change the scope, timing and direction as necessary during the audit.
- 5.2.4. The engagement partner shall take into account information obtained in the acceptance and continuance process in planning and performing the audit.
- 5.2.5. When information has been obtained from the previous experience with the client, or prior audits, the auditor shall evaluate whether such information remains relevant and reliable.

#### *Engagement Team Discussion*

- 5.2.6. The engagement partner and other key engagement team members shall discuss the susceptibility of the entity's financial statements to material misstatement, as well as:
- (a) The application of the applicable financial reporting framework to the entity's facts and circumstances.
  - (b) How and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur, and how fraud or error could arise from related party relationships or transactions.

Any discussions among the engagement team shall occur setting aside beliefs the engagement team may have that management, and where appropriate, those charged with governance are honest and have integrity.

*The engagement team discussion may also include other matters related to the audit such as the logistics, operational and other matters (such as where risks of material misstatement may have changed from prior years or matters related to relevant ethical requirement including independence) and the timing of the audit and communications that are required.*

- 5.2.7. When there are engagement team members not involved in the discussion, the engagement partner shall determine which matters are to be communicated to those members.

#### *Using the Work of Management's Expert*

- 5.2.8. If information to be used as audit evidence has been prepared using the work of management's expert, the auditor shall evaluate the competence, capabilities and objectivity of that expert, and evaluate the appropriateness of the expert's work as audit evidence for the relevant assertion.

#### *Determining Whether to Use the Work of an Auditor's Expert*

*The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. Nonetheless, if the auditor using the work of an auditor's expert concludes, based on the audit evidence obtained, that the work of*

*that expert is adequate for the auditor's purposes, the auditor may accept that expert's findings or conclusions in the expert's field as appropriate audit evidence.*

5.2.9. If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert.

*If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required to be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the audit engagement. Further, the auditor is required to ascertain the nature, timing and extent of resources necessary to perform the engagement. The auditor's determination of whether to use the work of an auditor's expert, and if so when and to what extent, assists the auditor in meeting these requirements. As the audit progresses, or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's expert.*

5.2.10. The auditor shall consider the following when determining the nature, timing and extent of procedures related to the auditor's expert:

- (a) The nature of the matter to which that expert's work relates;
- (b) The risks of material misstatement in the matter to which that expert's work relates;
- (c) The significance of that expert's work in the context of the audit;
- (d) The auditor's knowledge of and experience with previous work performed by that expert; and
- (e) Whether that expert is subject to the auditor's firm's quality management policies or procedures.

5.2.11. If the auditor is using the work of an auditor's expert, the auditor shall:

- (a) Evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purpose;
- (b) Obtain sufficient understanding of the field of expertise to enable the auditor to determine the nature, scope and objectives of the auditor's expert work; and
- (c) Agree in writing with the auditor's expert the nature, scope and objectives of the expert's work, the role of the expert and the auditor's responsibilities in relation to that work, the nature, timing and extent of communications and whether there is the need for the expert to observe confidentiality requirements.

#### *Going Concern*

5.2.12. The auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and:

- (a) If such an assessment has been performed, discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or

- (b) If such an assessment has not yet been performed, discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

*Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.*

- 5.2.13. The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

### **5.3. Materiality**

- 5.3.1. The auditor shall determine materiality for the financial statements as a whole.

*The concept of materiality is applied by the auditor in both planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements if any, on the financial statements and in forming an opinion in the auditor's report.*

*The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial needs of users of the financial statements. The auditor's professional judgment about misstatements that will be considered material provides a basis for:*

- *Determining the nature, timing and extent of procedures to identify and assess risks of material misstatement;*
- *Identifying and assessing the risks of material misstatement; and*
- *Determining the nature, timing and extent of further audit procedures.*

- 5.3.2. The auditor shall also determine the materiality level or levels to be applied to particular classes of transactions, account balances or disclosures if, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

- 5.3.3. The auditor shall determine performance materiality for the purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.

*Planning the audit solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated, and leaves no margin for possible undetected misstatements. Performance materiality (which, as defined, is one or more amounts) is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole.*

5.3.4. The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) if the auditor becomes aware of information during the audit that would have caused a lower materiality level to be determined initially.

5.3.5. If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.

#### **5.4. Specific Communication Requirements**

##### *Communications with Those Charged with Governance*

5.4.1. The auditor shall communicate to management, and where appropriate, those charged with governance an overview of the planned scope, timing and direction of the audit.

#### **5.5. Specific Documentation Requirements**

5.5.1. In addition to the general documentation requirements (Part 2.5.) for an audit engagement, the auditor shall include the scope, timing and direction of the audit, and significant changes made during the audit, together with the reasons for such changes, in the audit documentation.

5.5.2. The auditor shall document the discussion among the engagement team and significant decisions reached, including significant decisions regarding the susceptibility of the entity's financial statements to material misstatement due to fraud or error.

5.5.3. The auditor shall include in the audit documentation the following amounts and the factors considered in their determination of materiality (including any revisions as applicable):

- (a) Materiality for the financial statements as a whole;
- (b) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures; and
- (c) Performance materiality.

## 6. Risk Identification and Assessment

### Content of this Part

Part 6 contains the requirements relevant to the auditor's responsibility to perform procedures and related activities to:

- Understand the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control;
- Identify risks of material misstatement at the financial statement and assertion levels, whether due to fraud or error; and
- Assess inherent risk and control risk.

Appendix 2 illustrates the iterative nature of the auditor's risk identification and assessment.

### Scope of this Part

This Part deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, which provides the basis for the audit procedures undertaken to respond to assessed risks in Part 7.

### 6.1. Objectives

6.1.1. The objectives of the auditor are 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.

*Understanding the entity and its environment, the applicable financial reporting framework and the entity's system of internal control (the entity's internal control system) enables the auditor to identify and assess the risks of material misstatement. The auditor's risk identification and assessment process is iterative and dynamic. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's internal control system are interdependent with concepts within the requirements to identify and assess the risks of material misstatement.*

### 6.2. Procedures for Identifying and Assessing Risks and Related Activities

6.2.1. The auditor shall design and perform procedures to obtain audit evidence that provides an appropriate basis for:

- (a) The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels; and
- (b) The design of further audit procedures.

*The auditor uses professional judgment to determine the nature and extent of the procedures to be performed, which may vary with the formality of the entity's policies or procedures.*

*Some less complex entities, and particularly owner-managed entities, may not have established structured processes and systems (e.g., a risk assessment process or a process to monitor the entity's internal control system) or may have established processes or systems with limited documentation or a lack of consistency in how they are undertaken. When such systems and*

*processes lack formality, the procedures within this Part are still required to be completed, for example the auditor may still be able to perform the required procedures through observation and inquiry.*

*Designing and performing procedures to obtain audit evidence in a manner that is not biased may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of evidence.*

6.2.2. The procedures to identify and assess risks of material misstatement shall include:

- (a) Inquiries with management, and other appropriate individuals within the entity;
- (b) Analytical procedures. If unusual or unexpected trends and relationships are identified they shall be evaluated for fraud or error; and
- (c) Observation and inspection.

*The auditor is not required to perform all of these procedures for each aspect of the auditor's understanding required.*

#### *Considerations Specific to Public Sector Entities*

*When making inquiries of those who may have information that is likely to assist in identifying risks of material misstatement, auditors of public sector entities may obtain information from additional sources such as from the auditors that are involved in performance or other audits related to the entity. Procedures performed by auditors of public sector entities to identify and assess risks of material misstatement may also include observation and inspection of documents prepared by management for the legislature, for example documents related to mandatory performance reporting.*

#### *Automated Tools and Techniques*

*If the auditor uses ATT, the auditor may design and perform procedures to identify and assess risks of material misstatement on relatively large volumes of data (from the general ledger, sub-ledgers or other operational data) including for analysis, observation or inspection. For example, ATT may be used to observe or inspect particular assets, such as through the use of remote observation tools (e.g., a drone).*

6.2.3. In designing and performing procedures to identify and assess risks of material misstatement, the auditor shall consider possible risks of material misstatement arising from:

- (a) Fraud; and
- (b) Events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

#### *Fraud*

*Fraudulent financial reporting involves intentional misstatements, including omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively, such as recording fictitious journal entries close to the end of the financial reporting period.*

*Misappropriation of assets involves the theft of the 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 able to disguise or conceal misappropriations in ways that are difficult to detect.*

*Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.*

#### *Going Concern*

*Events or conditions that may cast significant doubt on the entity's ability to continue as a going concern of particular relevance to an LCE include the risk that banks and other lenders may cease to support the entity, as well as the possible loss of a principal supplier, major customer, key employee, or the right to operate under a license, franchise or other legal agreement.*

6.2.4. When identifying risks of material misstatement, including arising from fraud, the auditor shall consider information from:

- (a) The acceptance or continuance procedures; and
- (b) When applicable, other engagements performed by the engagement partner for the entity.

6.2.5. The auditor shall evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud.

6.2.6. When the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor shall evaluate whether such information remains relevant and reliable.

6.2.7. If the prior period's audit opinion on the prior year's financial statements was modified the auditor shall evaluate the effect on the current year's financial statements when identifying and assessing risks of material misstatement.

### **6.3. Understanding Relevant Aspects of the Entity**

*The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, establishes a frame of reference in which the auditor identifies and assesses the risks of material misstatement, and also informs how the auditor plans and performs further audit procedures.*

6.3.1. In understanding the entity and its environment and the applicable financial reporting framework, the auditor shall understand how inherent risk factors affect the susceptibility of assertions to misstatement, and the degree to which they do so.

6.3.2. For the entity's accounting estimates, the auditor shall take into account the degree to which the accounting estimate is subject to estimation uncertainty, and the degree to which the selection and application of the method, the assumptions and data used are affected by complexity, subjectivity or other inherent risk factors.

*Inherent risk factors may be qualitative or quantitative and affect the susceptibility of assertions to misstatement. Qualitative inherent risk factors relating to the preparation of information required by the applicable financial reporting framework include:*

- *Complexity;*
- *Subjectivity;*
- *Change;*
- *Uncertainty (for accounting estimates this is estimation uncertainty); or*
- *Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk.*

### *Understanding the Entity and Its Environment*

6.3.3. The auditor shall understand:

- (a) The entity's organizational structure, ownership and governance, business model (including how the entity uses IT in its business model).
- (b) The industry and other external factors.
- (c) How the entity's financial performance is measured internally and externally.
- (d) The legal and regulatory framework applicable to the entity, and how the entity is complying with that framework.
- (e) The entity's transactions and other events and conditions that may give rise to the need for, or changes in, accounting estimates to be recognized or disclosed. When an estimate is assessed to be significant for an item in the financial statements, the auditor shall understand the assumptions and methods used in determining the estimate.
- (f) Agreements or relationships that may result in unrecognized liabilities, future commitments or changes to current asset valuations through inspecting minutes of meetings and correspondence with legal counsel and inspecting legal expense accounts.

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

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

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

6.3.4. Unless all of those charged with governance are involved in managing the entity, the auditor shall understand 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 controls that management has established to mitigate these risks.

#### *Understanding the Applicable Financial Reporting Framework*

6.3.5. The auditor shall understand:

- (a) The applicable financial reporting framework, including for accounting estimates, the recognition criteria, measurement bases, and the related presentation and disclosure requirements and how these apply in the context of the nature and circumstances of the entity and its environment.
- (b) The entity's accounting policies and reasons for any changes thereto.

6.3.6. The auditor shall evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework.

#### *Understanding the Entity's Internal Control System*

*The auditor's understanding of the entity's internal control system influences the auditor's identification and assessment of the risks of material misstatement, and also assists the auditor in planning and designing further audit procedures. The entity's internal control system consists of the five components of internal control, for which an understanding is required for each:*

- *The control environment.*
- *The entity's risk assessment process.*
- *The entity's process to monitor the internal control system.*
- *The information system and communications.*
- *Control activities.*

*In less complex entities, and in particular owner-manager entities, the way in which the entity's internal control system is designed, implemented and maintained will vary with the entity's size and complexity. When there are no formal processes or documented policies or procedures, the auditor is still required to understand how management, or where appropriate, those charged with governance prevent and detect fraud and error, and use professional judgment to determine the nature and extent of the work to obtain the required understanding.*

*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 internal control system may be broader and more detailed.*

6.3.7. The auditor shall evaluate whether management (with the oversight of those charged with governance, if applicable) has created and maintained a control environment that provides an appropriate foundation for the other components of the entity's internal control system, including determining whether there are any deficiencies in this regard. For this purpose, the auditor shall understand:

- (a) How management, and where appropriate, those charged with governance, oversee the entity, and demonstrate integrity and ethical values;
- (b) The culture of the entity; and
- (c) How owner-managers have an active involvement and influence the risks arising from management override of controls due to lack of segregation of duties.

*The control environment provides an overall foundation for the operation of the other components of the entity's internal control system and deficiencies may undermine the rest of the entity's internal control system. Although it does not directly prevent or detect and correct misstatements, it may influence the effectiveness of other controls in the internal control system. 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 internal control system and its importance in the entity.*

*In the case of an LCE, some or all of the auditor's considerations may be inapplicable or less relevant. For example, an LCE may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Domination of management by a single individual in an LCE does not generally, in and of itself, indicate a failure by management to display and communicate an appropriate attitude regarding internal control and the financial reporting process. In some entities, the need for management authorization can compensate for otherwise deficient controls and reduce the risk of employee fraud. However, domination of management by a single individual can be a potential deficiency in internal control since there is an opportunity for management override of controls.*

- 6.3.8. The auditor shall evaluate whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity. For this purpose, the auditor shall understand the entity's risk assessment process relevant to the preparation of the financial statements (i.e., how risks are identified, assessed and addressed), including how this process identifies and addresses risks related to accounting estimates.

*Understanding how the entity assesses its business risks and other risks may assist the auditor in understanding where there are identified risks, and whether the entity has responded to those risks. This may inform the auditor in understanding whether the risks faced by the entity have been identified, assessed and addressed as appropriate to the nature and circumstances of the entity. For example, in some entities, particularly LCEs, the focus of management's assessment may be on the risks of employee fraud or misappropriation of assets.*

- 6.3.9. The auditor shall evaluate whether the entity's process for monitoring the internal control system is appropriate to the entity's circumstances considering the nature and complexity of the entity. For this purpose, the auditor shall understand the entity's process to monitor the entity's internal control system, including how deficiencies are remediated.

*Understanding the entity's monitoring of the internal control system assists the auditor to understand whether the entity's internal control system is present and functioning. In less complex entities, and in particular owner-manager entities, the auditor's understanding of the entity's process to monitor the entity's internal control system is often focused on how management or the*

*owner-manager is directly involved in operations, as there may not be any other formal monitoring activities.*

6.3.10. The auditor shall understand the information system relevant to the preparation of the financial statements, including:

- (a) For significant classes of transactions, account balances and disclosures, how those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements, as well as:
  - (i) How the information system captures, processes and discloses events and conditions, other than transactions;
  - (ii) The accounting and other supporting records for the flows of information;
  - (iii) The entity's resources used in the financial reporting process;
  - (iv) The IT environment; and
- (b) The financial reporting process used to prepare the entity's financial statements, including disclosures.

In doing so, the auditor shall evaluate whether the entity's information system appropriately supports the preparation of the entity's financial statements in accordance with the applicable financial reporting framework.

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

- *Inquiries of relevant personnel about the procedures used to initiate, record, process and report transactions or about the entity's financial reporting process;*
- *Inspection of policy or process manuals or other documentation of the entity's information system;*
- *Observation of the performance of the policies or procedures by entity's personnel; or*
- *Selecting transactions and tracing them through the applicable process in the information system (i.e., performing a walk-through).*

*The information system, and related business processes, in less complex entities are likely to involve a less complex IT environment; however, the role of the information system is just as important when identifying and assessing risks of material misstatement. Less complex entities with direct management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the relevant aspects of the entity's information system may therefore require less effort in an audit of an LCE, and may involve a greater amount of inquiry than observation or inspection of documentation.*

#### *Automated Tools and Techniques*

*The auditor may also use ATT to obtain direct access to, or a digital download from, the databases in the entity's information system that store accounting records of transactions. By applying ATT to this information, the auditor may confirm the understanding obtained about how transactions flow through the information system by tracing journal entries, or other digital records related to a particular transaction, or an entire population of transactions, from initiation in the accounting*

*records through to recording in the general ledger. Analysis of complete or large sets of transactions may also result in the identification of variations from the normal, or expected, processing procedures for these transactions, which may result in the identification of risks of material misstatement.*

- 6.3.11. For accounting estimates, the auditor's understanding of the information system relevant to the preparation of the financial statements shall include:
- (a) How the accounting estimates are made, the models used, the source of data, and the selection of assumptions;
  - (b) How management reviews the outcomes of previous estimates and responds to the results of that review; and
  - (c) A review of the outcome of previous accounting estimates, or, if applicable, their subsequent re-estimation.
- 6.3.12. The auditor shall understand how the entity communicates significant matters related to the preparation of the financial statements, and related reporting responsibilities, between people within the entity, between management and those charged with governance (if applicable) and with external parties (such as regulatory authorities or others as required).
- 6.3.13. Based on the auditor's evaluations about whether the control environment, the entity's risk assessment process, the monitoring of the entity's internal control system and the information system are appropriate in context of the nature and circumstances of the entity, the auditor shall determine whether one or more control deficiencies have been identified.
- 6.3.14. The auditor shall identify controls that address risks of material misstatement at the assertion level as follows:
- (a) Controls that address risks determined to be significant risks;
  - (b) Controls over journal entries including to record non-recurring unusual transactions or adjustments;
  - (c) Controls for which the auditor plans to test the operating effectiveness of controls, including those controls that address risks for which substantive procedures alone are not enough to obtain sufficient appropriate audit evidence;
  - (d) Other controls, based on the auditor's professional judgment, where the auditor considers it appropriate to meet the objectives of identifying risks of material misstatement at the assertion level;
  - (e) If applicable, controls that relate to information processed by a service organization; and
  - (f) Controls, if any, to identify, account for, and disclose related party relationships in accordance with the applicable financial reporting framework, authorize and approve significant transactions and relationships with related parties, and authorize and approve significant transactions and arrangements outside the normal course of business.

For each control identified in (a)–(f) above, the auditor shall evaluate whether the control is designed effectively, and determine whether the control has been implemented, by performing procedures more than inquiry.

*The auditor is required to identify specific controls, evaluate the design and determine whether the controls have been implemented. This assists the auditor's understanding of management's approach to addressing certain risks, and therefore provides a basis for the design and performance of further audit procedures responsive to these risks even when the auditor does not plan to test the operating effectiveness of identified controls.*

*Controls that address risks of material misstatement at the assertion level that are expected to be identified for all audits are controls over journal entries, because the manner in which an entity incorporates information from transaction processing into the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. The extent to which other controls are identified may vary based on the nature of the entity and the auditor's planned approach to further audit procedures, for example, in an audit of an LCE, the entity's information system may not be complex and the auditor may not plan to rely on the operating effectiveness of controls. Further, the auditor may not have identified any significant risks or any other risks of material misstatement for which it is necessary for the auditor to evaluate the design of controls and determine that they have been implemented. In such an audit, the auditor may determine that there are no identified controls other than the entity's controls over journal entries.*

6.3.15. For the controls identified in paragraph 6.3.14. the auditor shall identify:

- (a) The IT applications and other aspects of the IT environment that are subject to risks arising from the use of IT; and
- (b) The related risks arising from the use of IT.

6.3.16. For those risks arising from the use of IT identified, the auditor shall identify the entity's general IT controls, and evaluate whether the general IT controls are effectively designed and determine whether the control has been implemented by performing procedures more than inquiry.

*The auditor's understanding of the information system (which may be done by performing walkthrough procedure) includes the IT environment relevant to the flows of transactions and processing of information in the entity's information system. This is because the entity's use of IT applications or other aspects of the IT environment may give rise to risks arising from IT (i.e., the susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of information).*

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

6.3.17. If the entity uses the services of a service organization, the auditor's understanding of the information system shall include:

- (a) The nature of the services provided by the service organization and the significance of those services to the entity;
- (b) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization;
- (c) The relevant contractual terms for the activities undertaken by the service organization;

- (d) Controls at the service organization relevant to the entity's transactions; and
- (e) The controls applied to transactions with the service organization.

#### *Deficiencies in the Entity's Internal Control System*

6.3.18. The auditor shall determine whether any deficiencies identified in the entity's internal control system, individually or in combination, constitute significant deficiencies.

#### **6.4. Identifying Risks of Material Misstatement**

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

6.4.1. The auditor shall identify the risks of material misstatement, due to fraud or error, at:

- (a) The financial statement level; and
- (b) The assertion level for classes of transactions, account balances, and disclosures.

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

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

*In identifying and assessing the risks of material misstatement, the auditor uses assertions to consider the different types of potential misstatements that may occur. Appendix 4 sets out assertions that may be used by the auditor in considering different types of misstatements at the assertion level.*

6.4.2. In identifying the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

*The presumption that there are risks of fraud in revenue recognition may be rebutted. For example, the auditor may conclude, based on the audit evidence obtained, that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property.*

6.4.3. The auditor shall determine the relevant assertions and the related significant classes of transactions, account balances and disclosures.

*Determining relevant assertions and the significant classes of transactions, account balances and disclosures provides the basis for the scope of the auditor's understanding of the entity's information system required to be obtained, and the identification and assessment of risks of material misstatement.*

## 6.5. Risk Assessment

### Assessing Inherent Risk

6.5.1. For identified risks of material misstatement, the auditor shall assess:

- (a) The risks of material misstatement at the financial statement level. In doing so, the auditor shall determine whether such risks affect risks at the assertion level, and evaluate the nature and extent of their pervasive effect on the financial statements; and
- (b) Inherent risk for identified risks of material misstatement at the assertion level by assessing the likelihood and magnitude of misstatement. In doing so, the auditor shall take into account the degree to which inherent risk factors, including estimation uncertainty for the entity's accounting estimates, affect the susceptibility of the relevant assertions to misstatement.

*The assessed inherent risk for a particular risk of material misstatement at the assertion level represents a judgment within a range, from lower to higher, on the spectrum of inherent risk.*

*In assessing inherent risk, the auditor uses professional judgment in determining the significance of the combination of the likelihood and magnitude of a misstatement on the spectrum of inherent risk. The judgment about where in the range inherent risk is assessed may vary based on the nature, size or circumstances of the entity, and takes into account the assessed likelihood and magnitude of the misstatement and inherent risk factors.*

*In considering the likelihood of a misstatement, the auditor considers the possibility that a misstatement may occur, based on consideration of the inherent risk factors. In considering the magnitude of a misstatement, the auditor considers the qualitative and quantitative aspects of the possible misstatement (i.e., misstatements in assertions about classes of transactions, account balances or disclosures may be judged to be material due to nature, size or circumstances).*

#### *Considerations Specific to Public Sector Entities*

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

6.5.2. The auditor shall determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material misstatement at the assertion level.

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

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

### Significant Risks

6.5.3. The auditor shall determine whether any of the assessed risks of material misstatement are, in the auditor's professional judgment, a significant risk.

*The determination of which of the assessed risks of material misstatement are close to the upper end of the spectrum of inherent risk, and are therefore significant risks, is a matter of professional judgment, unless the risk is of a type specified to be treated as a significant risk as set out in paragraphs 6.5.4.–6.5.5. Being close to the upper end of the spectrum of inherent risk will differ from entity to entity, and will not necessarily be the same for an entity period on period. It may depend on the nature and circumstances of the entity for which the risk is being assessed.*

6.5.4. In exercising professional judgment as to which assessed risks are significant risks, the auditor shall consider at least the following:

- (a) Whether the risk is a risk of fraud (e.g., because of management override of controls or a presumed risk of fraud such as in revenue recognition).
- (b) Whether the risk involves significant transactions with related parties.
- (c) How, in the case of accounting estimates, the inherent risk factors, such as the complexity of transactions and the degree of subjectivity in the measurement of financial information related to the risk, including those measurements involving a wide range of measurement uncertainty, have influenced the auditor's assessment on the spectrum of risk.
- (d) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

6.5.5. The auditor shall treat:

- (a) Identified fraud risks as significant risks; and
- (b) Identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks.

### Assessing Control Risk

6.5.6. If the auditor plans to test the operating effectiveness of controls the auditor shall assess control risk, otherwise the risk of material misstatement is the same as the assessment of inherent risk.

*The auditor's plans to test the operating effectiveness of controls is based on the expectation that controls are operating effectively, and this will form the basis of the auditor's assessment of control risk.*

*The initial expectation of the operating effectiveness of controls is based on the auditor's evaluation of the design, and the determination of implementation, of the controls identified in paragraphs 6.3.14. and 6.3.16. Once the auditor has tested the operating effectiveness of the controls in accordance with Part 7, the auditor will be able to confirm the initial expectation about the operating effectiveness of controls. If the controls are not operating effectively as expected, then the auditor will need to revise the control risk assessment.*

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

### *Evaluation of the Procedures to Identify and Assess Risks of Material Misstatement and Revision of Risk Assessment*

6.5.7. The auditor shall evaluate whether the audit evidence obtained from procedures to identify and assess the risks of material misstatement provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, the auditor shall perform additional procedures until audit evidence has been obtained to provide such a basis.

6.5.8. 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.

### *Evaluation of the Appropriateness of Using the ISA for LCE*

6.5.9. The engagement partner shall evaluate whether the ISA for LCE continues to be appropriate for the nature and circumstances of the entity being audited.

*The auditor's original determination to use the ISA for LCE may change as new information or additional audit evidence is obtained when performing procedures to identify and assess risks of material misstatement. In circumstances where audit evidence, or new information, is obtained, which is inconsistent with the auditor's original determination for using the ISA for LCE, the auditor may need to change the original determination to use the ISA for LCE.*

## **6.6. Specific Inquiries of Management and Those Charged with Governance**

6.6.1. In designing and performing procedures to identify and assess the risks of material misstatement due to fraud or error, the auditor shall make inquiries of management regarding:

- (a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments;
- (b) Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist;
- (c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity;
- (d) Management's communication, if any, to employees regarding its views on business practices and ethical behavior;
- (e) The identity of the entity's related parties, including changes from the prior period; the nature of the relationships between the entity and these related parties; and whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions;

- (f) Non-compliance with law or regulation that may have a material effect on the financial statements, and inspecting correspondence, if any, with the relevant licensing or regulatory authorities; and
- (g) Events or conditions that exist that individually, or collectively, may affect the ability of the entity to continue as a going concern.

6.6.2. The auditor shall make inquiries of management, and as appropriate, those charged with governance, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.

## 6.7. Specific Communication Requirements

6.7.1. The auditor shall communicate to management, and where appropriate, those charged with governance, the significant risks identified by the auditor.

## 6.8. Specific Documentation Requirements

*The form and extent of documentation for the identification and assessment of the risks of material misstatement may be simple and relatively brief, and is influenced by:*

- *The nature, size and complexity of the entity and its internal control system.*
- *Availability of information from the entity.*
- *The audit methodology and technology used in the course of the audit.*

*It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it, but rather apply the principles in Part 2.5 and the matters noted below.*

6.8.1. In addition to the general documentation requirements (Part 2.5.) for an audit of an LCE, the auditor shall include the following in the audit documentation:

- (a) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment, the applicable financial reporting framework and the entity's internal control system;

*Key elements of understanding documented by the auditor may include those on which the auditor based the assessment of risks of material misstatement.*

- (b) The names of the identified related parties (including changes from prior period), the nature of the related party relationships, and whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions;
- (c) The identified and assessed risks of material misstatement, including risks due to fraud, at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made;

*The auditor is required to take into account the inherent risk factors when identifying and assessing the risks of material misstatement. However, the auditor is not required to document how every inherent risk factor was taken into account in relation to each class of transaction, account balance or disclosure.*

- (d) If applicable, the reasons for the conclusion that there is not a risk of material misstatement due to fraud related to revenue recognition.
- (e) The controls set out in paragraphs 6.3.14. and 6.3.16 and the evaluation whether the control is designed effectively and determination whether the control has been implemented;
- (f) For accounting estimates, key elements of the auditor's understanding of the accounting estimates, including controls as appropriate, the linkage of the assessed risks of material misstatements to the auditor's further procedures, and any indicators of management bias and how those were addressed; and
- (g) Identified or suspected non-compliance with law or regulation and the results of discussion with management, and where appropriate, those charged with governance and parties outside the entity.

6.8.2. The auditor shall document the evaluation about whether the ISA for LCE continues to be appropriate for the nature and circumstances of the entity being audited.

## **7. Responding to Assessed Risks of Material Misstatement**

### *Content of this Part*

Part 7 contains content related to the:

- Design and implementation of overall responses to assessed risks of material misstatement at the financial statement level;
- Design and implementation of responses to the assessed risks of material misstatement at the assertion level (i.e., design and performance of further audit procedures). Further procedures include substantive procedures (tests of detail and substantive analytical procedures) and tests of controls (as appropriate), and is expanded on in this Part; and
- Procedures for specific topics when responding to assessed risks of material misstatement.

### *Scope of this Part*

This Part sets out the specific requirements for obtaining audit evidence through responding to assessed risks of material misstatement. Part 2 also sets out the broad requirements for audit evidence. In complying with the requirements in this Part, the auditor may find it useful to refer to the following that set out relevant matters:

- Fraud – see Part 1.5.
- Law or regulation – see Part 1.6.
- Related parties – see Part 1.7.
- Information to be used as audit evidence – see Part 2.3.
- Procedures for obtaining audit evidence – see Part 2.4.

### **7.1. Objectives**

7.1.1. The objectives of the auditor are to:

- (a) Obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement (the assessed risks), through designing and implementing responses to those risks;
- (b) Respond, as appropriate, to risks of material misstatement arising from fraud or suspected fraud;
- (c) Obtain sufficient appropriate audit evidence regarding management's use of the going concern assumption and related disclosures; and
- (d) Respond to instances of non-compliance with law or regulation that may have a material effect on the financial statements.

## **7.2. Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Financial Statement Level**

7.2.1. The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level, whether due to fraud or error.

*The auditor's overall responses at the financial statement level, for example, making general changes to the nature, timing or extent of audit procedures, or adjustments to resources assigned or using experts, are based on those risks that relate pervasively to the financial statements as a whole. These may include, for example, risks arising from industry, regulatory and other external factors, or matters related broadly to the entity's basis of accounting or accounting policies.*

*In particular, the auditor's overall responses also are influenced by the auditor's understanding of the control environment. The control environment provides a foundation for the operation of the other components of the entity's internal control system. The control environment does not directly prevent, or detect and correct, misstatements. It may, however, influence the effectiveness of controls in the other components of the entity's internal control system. Therefore, an effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity.*

*Deficiencies that have been identified in the control environment when obtaining an understanding of the entity's internal control system, however, have the opposite effect and may result in the need for more extensive audit evidence from substantive procedures. A weak control environment also impacts the work that may be undertaken at an interim period.*

7.2.2. In determining overall responses to address assessed risks of material misstatement, due to fraud or error, at the financial statement level, the auditor shall:

- (a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud or error for the engagement;
- (b) Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements, may be indicative of errors or fraudulent financial reporting resulting from management's effort to manage earnings; and
- (c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures.

## **7.3. Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level**

7.3.1. The auditor shall design and perform further audit procedures whose nature, timing and extent are based on, and responsive to, assessed risks, whether due to fraud or error, at the assertion level.

*Further audit procedures comprise tests of controls and substantive procedures. The auditor may choose to perform tests of controls or they may be required in specific circumstances (see paragraph 7.3.2.(d)). Substantive procedures include tests of details detail and substantive analytical procedures.*

*Further audit procedures are responsive to the assessed risk of material misstatement at the assertion level, and provide a clear linkage between the auditor's further procedures and the risk*

*assessment. If the assessed risks of material misstatement are due to fraud risks at the assertion level, the nature, timing and extent of audit procedures may need to be changed to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information.*

7.3.2. In designing the further audit procedures, 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, or disclosure, including:
  - (i) The likelihood and magnitude of misstatement due to the characteristics of the significant class of transactions, account balance, or disclosure (that is, the inherent risk); and
  - (ii) Whether the risk assessment takes account of controls that address the risk of material misstatements (that is, the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (where the auditor plans to test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures);
- (b) Obtain more persuasive audit evidence the higher the auditor's assessment of risk;
- (c) In designing and performing tests of controls, obtain more persuasive audit evidence the greater the reliance the auditor places on the operating effectiveness of controls; and
- (d) Design and perform tests of controls if the auditor intends to rely on the operating effectiveness of controls or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

*In an audit of an LCE, the auditor may not be able to identify many controls, or the extent of documentation prepared by the entity to which they exist or operate may be limited. In such cases, it may be more efficient for the auditor to perform further audit procedures that are primarily substantive procedures.*

*When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.*

#### *Considerations Specific to Public Sector Entities*

*For the audits of public sector entities, the audit mandate and any other special auditing requirements may affect the auditor's consideration of the nature, timing and extent of further audit procedures.*

7.3.3. The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws or regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.

7.3.4. When designing tests of controls and tests of details, the auditor shall determine the means of selecting items for testing that are effective in meeting the purpose of the audit procedure.

### *Substantive Analytical Procedures*

7.3.5. If the auditor uses analytical procedures to obtain audit evidence, the auditor shall:

- (a) Determine the suitability of the substantive analytical procedure for the purpose of the test and for the given assertion(s);
- (b) Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed;
- (c) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify misstatements;
- (d) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation being required; and
- (e) Investigate fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, by inquiring of management and obtaining appropriate audit evidence and relevant to management's responses, performing additional audit procedures as necessary in the circumstances.

#### *Automated Tools and Techniques*

*Analytical procedures can be performed using a number of tools or techniques, which may also be automated. The evolution of technology, coupled with the increase in number and variety of sources of data, may create more opportunities for the auditor to use ATT in performing substantive analytical procedures.*

*There are countless information sources available (e.g., social media, free access information sources) to the auditor, and some are more reliable than others. The use of ATT to perform substantive analytical procedures allows the auditor to incorporate information from more sources both internal and external to the entity and also to use much greater volumes of data in the analyses. Nonetheless, the auditor's responsibility for addressing the reliability of data used in substantive analytical procedures is unchanged.*

### *Audit Sampling*

7.3.6. If the auditor uses audit sampling when responding to assessed risks of material misstatement as a means for selecting items for testing, the auditor shall:

- (a) Consider the purpose of the audit procedures and the characteristics of the population from which the sample will be drawn.
- (b) Determine a sample size sufficient to reduce sampling risk to an acceptably low level.
- (c) Select items in a way that each sampling unit in the population has a chance of selection.
- (d) Perform audit procedures, appropriate to the purpose, on each item selected, unless the procedure is not applicable to the selected item in which case the auditor shall select a replacement item or perform a suitable alternative procedure. If the auditor is unable to apply the procedure to the selected item, unless it is not applicable, that item will be treated as a deviation (in the case of tests of controls) or a misstatement (in the case of tests of details).

- (e) Investigate deviations or misstatements identified in the sample as to their nature and cause, and consider their effect on the purpose of the audit procedure and other areas of the audit.
- (f) For tests of details, project misstatements found in the sample to the population.

7.3.7. In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population. The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.

*A misstatement that has been established to be an anomaly need not be projected across the remaining population.*

7.3.8. The auditor shall evaluate:

- (a) The results of the sample; and
- (b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

#### *Tests of Controls*

7.3.9. If the auditor is planning to place reliance on the effectiveness of controls, the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of such controls. If the control is over a significant risk, the auditor shall test the control in the current period.

7.3.10. When performing test of controls, the auditor shall perform audit procedures in combination with inquiry to obtain audit evidence about controls, including:

- (a) How the controls were applied at relevant times during the period;
- (b) The consistency with which they were applied; and
- (c) By whom and what means they were applied.

7.3.11. The auditor shall determine whether the controls to be tested depend on other controls, and if so, consider whether it is necessary to obtain evidence about the effective operation of the other controls.

7.3.12. If deviations from controls, upon which the auditor intends to rely, are detected, the auditor shall make specific inquiries to understand deviations and the potential consequences, including whether the tests of controls provide an appropriate basis for reliance on the controls.

#### *Substantive Procedures*

7.3.13. Irrespective of the assessed risks, substantive procedures shall be performed for each material class of transactions, account balance, and disclosure.

7.3.14. The auditor's substantive procedures shall include audit procedures related to the financial statement closing process, including:

- (a) Agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers; and

- (b) Examining material journal entries and other adjustments made during the course of preparing the financial statements.

7.3.15. The auditor's substantive procedures shall include substantive procedures specifically responsive to significant risks. When the response to a significant risk consists only of substantive procedures, those procedures shall include tests of details.

#### *Using Audit Evidence Obtained During an Interim Period*

7.3.16. If the auditor obtains audit evidence about the operating effectiveness of controls in an interim period, the auditor shall obtain evidence about significant changes to those controls subsequent to the interim period and determine additional evidence to be obtained for the remaining period.

7.3.17. If the auditor performed substantive procedures at an interim date, the auditor shall cover the remaining period by performing:

- (a) Substantive procedures, combined with tests of controls for the intervening period; or
- (b) If the auditor determines that it is sufficient, further substantive procedures only, that provide a reasonable basis for extending the audit conclusions from the interim date to the period end.

#### *External Confirmations*

7.3.18. The auditor shall consider whether external confirmation procedures are to be performed as substantive procedures.

*External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions.*

7.3.19. When using external confirmation procedures, the auditor shall maintain control over:

- (a) Determining the information to be confirmed or requested and selecting the appropriate confirming party.
- (b) Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
- (c) Sending the requests, including follow-up requests when applicable, to the confirming party.

7.3.20. If management refuses to allow the auditor to send a confirmation request, the auditor shall:

- (a) Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;
- (b) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and
- (c) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

7.3.21. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from

alternative audit procedures, the auditor shall communicate with those charged with governance. The auditor also shall determine the implications for the audit and the auditor's opinion.

- 7.3.22. If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts. If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures.
- 7.3.23. In the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence.
- 7.3.24. The auditor shall evaluate whether the results of the external confirmation procedures, if any, provide relevant and reliable audit evidence, or whether further audit evidence is necessary.

#### 7.4. Specific Focus Areas

##### *Going Concern*

- 7.4.1. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern.

*In many cases, the management of less complex entities may not have prepared a detailed assessment of the entity's ability to continue as a going concern, but instead may rely on in-depth knowledge of the business and anticipated future prospects. Nevertheless, in accordance with the requirements of this Part, the auditor evaluates management's assessment of the entity's ability to continue as a going concern.*

- 7.4.2. In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the same period as used by management. If that period is less than twelve months from the date of the financial statements, the auditor shall ask management to extend the period. If management does not make or extend its assessment, the auditor shall consider the implications for the auditor's report (e.g., a qualified opinion or disclaimer of opinion may be appropriate because the auditor is unable to obtain sufficient appropriate audit evidence).

*The auditor also remains alert to the possibility that there are known events, scheduled or otherwise, or conditions that will occur beyond the period of assessment used by management that may bring into question management's use of the going concern basis of accounting in preparing the financial statements. The further into the future the events or conditions are, the more significant the going concern issues need to be before the auditor takes further action. If events or conditions that may cast significant doubt on the entity's ability to continue as a going concern are identified after the auditor's risk assessments are made, the auditor's assessment of the risks of material misstatement may need to be revised.*

- 7.4.3. In evaluating management's assessment, the auditor shall consider whether management's assessment includes all relevant information of which the auditor is aware of as a result of the audit.
- 7.4.4. The auditor shall inquire of management as to its knowledge of events or conditions beyond the period of management's assessment that may cast significant doubt on the entity's ability to continue as a going concern.

7.4.5. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional procedures, including consideration of mitigating factors (a "material uncertainty" relates to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern). These procedures shall include:

- (a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
- (b) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
- (c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:
  - (i) Evaluating the reliability of the underlying data generated to prepare the forecast; and
  - (ii) Determining whether there is adequate support for the assumptions underlying the forecast.
- (d) Considering whether any additional facts or information have become available since the date on which management made its assessment.
- (e) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

*A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is, for a fair presentation framework, necessary for the fair presentation of the financial statements or, for a compliance framework, necessary for the financial statements not to be misleading.*

#### *Management Override of Controls*

7.4.6. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and therefore a significant risk.

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

- (a) Test the appropriateness of manual and automated journal entries recorded in the general ledger and other adjustments, made in the preparation of the financial statements, including:
  - (i) Making inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
  - (ii) Selecting journal entries and other adjustments made at the end of a reporting period; and

- (iii) Considering the need to test journal entries and other adjustments throughout the period.
- (b) Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud, including:
  - (i) Evaluate whether the judgments and decisions made by management indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, the auditor shall reevaluate the accounting estimates taken as a whole; and
  - (ii) Perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year.
- (c) For significant unusual transactions, evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.
- (d) Respond to the identified risks of management override of controls to the extent not already addressed by (a) to (c).

*Material misstatement of financial statements due to fraud often involves the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries. This may occur throughout the year or at period end, or both, or by management making adjustments to amounts reported in the financial statements that are not reflected in journal entries, such as through reclassifications.*

#### *Automated Tools and Techniques*

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

#### *Related Parties*

- 7.4.8. The auditor shall design and perform further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions.
- 7.4.9. For identified arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, the auditor shall:
- (a) Determine whether the underlying circumstances confirm the existence of those relationships or transactions;
  - (b) Promptly communicate the relevant information to the other members of the engagement team;
  - (c) Where the applicable financial reporting framework establishes related party requirements:
    - (i) Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation;

- (ii) Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions;
  - (d) Perform appropriate substantive audit procedures for such newly identified related parties or significant related party transactions;
  - (e) Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor, and perform additional audit procedures as necessary; and
  - (f) If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit.
- 7.4.10. For significant related party transactions outside of the entity's normal course of business the auditor shall inspect the underlying contracts or agreements, if any, and evaluate whether:
- (a) The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;
  - (b) The terms of transactions are consistent with management's explanations; and
  - (c) The transactions have been appropriately accounted for, presented and disclosed in accordance with the applicable financial reporting framework.
- 7.4.11. If management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor shall obtain sufficient appropriate audit evidence about the assertion.

#### *Accounting Estimates*

- 7.4.12. The auditor shall design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the assertion level for disclosures related to an accounting estimate.
- 7.4.13. The auditor's further audit procedures on an accounting estimate 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. In doing so, the auditor shall consider any changes in circumstances and other relevant conditions between the event and the measurement date that may affect the relevance of such evidence;
  - (b) Testing how management made the accounting estimate. In doing so, the auditor shall consider:
    - (i) Whether the method selected is appropriate;
    - (ii) Whether the significant assumptions and data are appropriate, whether the judgments made in selecting these give rise to indicators of possible management bias, and whether the data is relevant and reliable in the circumstances;
    - (iii) Whether calculations are mathematically accurate and whether judgements have been applied consistently; or

- (c) Developing an auditor's point estimate or range. In doing so, the auditor shall determine that the range includes only amounts that are supported by sufficient appropriate audit evidence and have been evaluated by the auditor to be reasonable in the context of the circumstances of the entity and the applicable financial reporting framework.

#### *Inventory*

7.4.14. If inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

- (a) Attendance at physical inventory counting, unless impracticable, to:
  - (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
  - (ii) Observe the performance of management's count procedures;
  - (iii) Inspect the inventory; and
  - (iv) Perform test counts; and
- (b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

7.4.15. If the auditor has not attended the inventory count, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions. If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory, or determine the effect on the auditor's report.

*In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. In some cases where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory. In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, the auditor is required to modify the opinion in the auditor's report as a result of the scope limitation.*

#### *Litigation and Claims*

7.4.16. The auditor shall design and perform further audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

- (a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
- (b) Inspecting minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
- (c) Inspecting legal expense accounts.

*Audit Procedures When Non-Compliance with Law or Regulation is Identified or Suspected*

7.4.17. If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with law or regulation, the auditor shall:

- (a) Understand the nature and circumstances, and obtain further information necessary to evaluate the possible effect on the financial statements;
- (b) Discuss the non-compliance with management, and where appropriate, those charged with governance, unless prohibited to do so by law or regulation;
- (c) If sufficient information about suspected non-compliance cannot be obtained, evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion if sufficient information cannot be obtained; and
- (d) Evaluate the implications on other aspects of the audit, including the auditor's risk assessment and the reliability of written representations.

*Using the Services of a Service Organization*

7.4.18. If the entity is using the services of a service organization, the auditor shall:

- (a) Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available at the entity; and, if not,
- (b) Perform further audit procedures to obtain sufficient appropriate audit evidence or use another auditor to perform those procedures at the service organization on the auditor's behalf.

*Smaller entities may use external bookkeeping services ranging from the processing of certain transactions (for example, payment of payroll taxes) and maintenance of their accounting records to the preparation of their financial statements. The use of such a service organization for the preparation of its financial statements does not relieve management of the smaller entity and, where appropriate, those charged with governance of their responsibilities for the financial statements.*

*Using the Work of an Auditor's Expert*

7.4.19. When the auditor has used the work of an auditor's expert, the auditor shall evaluate the adequacy of the auditor's expert's work, including:

- (a) The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;
- (b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and
- (c) If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.

**7.5. Accumulation of Misstatements**

7.5.1. The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial.

*Misstatements that are clearly trivial will be of a wholly different (smaller) order of magnitude, or of a wholly different nature than those that would be determined to be material, and will be*

*misstatements that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of nature, size or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the misstatement is considered not to be clearly trivial.*

7.5.2. If the auditor identifies a misstatement during the audit, the auditor shall evaluate whether the misstatement is indicative of fraud. If there is such an indication, the auditor shall determine the implications on other aspects of the audit, including on the identified and assessed risks of material misstatement and the reliability of management representations.

7.5.3. If the auditor identifies a misstatement that may be the result of fraud, and suspects that management is involved, the auditor shall:

- (a) Reevaluate the risks of material misstatement due to fraud and the auditor's responses thereto; and
- (b) Consider whether circumstances or conditions indicate possible collusion involving employees, management or third parties when reconsidering the reliability of evidence previously obtained.

*The implications of identified or suspected fraud depends on the circumstances. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of evidence previously obtained may be called into question, since there may be doubts about the completeness and truthfulness of representations made and about the genuineness of accounting records and documentation. There may also be a possibility of collusion involving employees, management or third parties.*

7.5.4. The auditor shall determine whether the audit plan needs to be revised if:

- (a) The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; and
- (b) The aggregate of misstatements accumulated during the audit approaches materiality determined.

## **7.6. Specific Communication Requirements**

7.6.1. The auditor shall communicate:

- (a) In writing, significant deficiencies in the entity's internal control system identified during the audit to those charged with governance on a timely basis.
- (b) With management, on a timely basis, matters that have been communicated to those charged with governance and other deficiencies that have not been communicated but are of sufficient importance to merit management's attention.

*The communication of other deficiencies in internal control that merit management's attention need not be in writing but may be oral.*

7.6.2. Where significant deficiencies are in writing, the auditor shall include a description and explanation of the potential impact of the deficiencies, and sufficient information to understand the context of the communication.

7.6.3. In communicating with management and, where appropriate, those charged with governance, the auditor shall consider if there are any matters to communicate regarding accounting estimates, taking into account whether the reasons given to the risks of material misstatement relate to estimation uncertainty, or the effects of complexity, subjectivity or other inherent risk factors in making accounting estimates and related disclosures.

## 7.7. Specific Documentation Requirements

7.7.1. In addition to the general documentation requirements (Part 2.5.) for an audit engagement, the auditor shall include the following in the audit documentation:

- (a) The overall responses to the assessed risks of material misstatement at the financial statement level;
- (b) The nature, timing and extent of further audit procedures performed in response to risks of material misstatement at the assertion level;
- (c) The linkage between the procedures performed and the assessed risks at the assertion level;
- (d) The results of the audit procedures, including the conclusions where these are not otherwise clear, and
- (e) The results of audit procedures designed to address the risk of management override of controls.

7.7.2. Where the assessed risk of material misstatement is due to fraud, the auditor's documentation shall include the specific fraud response.

7.7.3. Where the auditor has identified or suspected non-compliance with law or regulation, the auditor shall document the audit procedures performed, the significant professional judgments made, and the conclusions reached thereon.

7.7.4. For accounting estimates, the auditor shall include key elements of the auditor's understanding of the accounting estimates, including controls as appropriate, the linkage of the assessed risks of material misstatements to the auditor's further procedures, and any indicators of management bias and how those were addressed.

## 8. **Concluding**

### *Content of this Part*

Part 8 sets out the requirements for the:

- Evaluating corrected and uncorrected misstatements identified during the audit.
- The auditor's consideration of the effect of subsequent events.
- Auditor's evaluations as to whether sufficient appropriate audit evidence has been obtained, including for relevant assertions, and other activities, to be able to conclude.
- Auditor's conclusion about management's use of the going concern assumption and related disclosures.
- Other concluding activities, including obtaining written representations and performing concluding analytical procedures.

### *Scope of this Part*

The evaluations performed and the conclusions reached will form the basis for the auditor's opinion in Part 9.

### **8.1. Objectives**

8.1.1. The objectives of the auditor are to:

- (a) Evaluate the effect of identified misstatements, if any, on the audit and the effect of any uncorrected misstatements on the financial statements;
- (b) Conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and
- (c) Conclude on whether sufficient appropriate audit evidence has been obtained on which to base the auditor's opinion.

### **8.2. Evaluation of Misstatements Identified During the Audit**

8.2.1. The auditor shall request management to correct all misstatements accumulated during the audit. If management has examined a class of transactions, account balance or disclosure and corrected identified misstatements, the auditor shall perform additional procedures to determine whether misstatements remain.

8.2.2. Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality to confirm whether it remains appropriate in the context of the entity's actual financial results.

8.2.3. The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate by considering the:

- (a) Nature and size of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and

- (b) Effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

### 8.3. Analytical Procedures that Assist When Forming an Overall Conclusion

- 8.3.1. The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity, and to identify any indications of a previously unrecognized risk of material misstatement.
- 8.3.2. The auditor shall investigate fluctuations or relationships that are inconsistent with other relevant information obtained during the course of the audit, by inquiring of management and performing other procedures as necessary in the circumstances.

### 8.4. Subsequent Events

*Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:*

- (a) *Those that provide evidence of conditions that existed at the date of the financial statements; and*
- (b) *Those that provide evidence of conditions that arose after the date of the financial statements.*

- 8.4.1. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.
- 8.4.2. The auditor shall perform procedures to cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto, including:
  - (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
  - (b) Inquiring of management, and where appropriate, those charged with governance, as to whether any subsequent events have occurred that may affect the financial statements.
  - (c) Reading minutes of meetings held after the balance sheet date and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- 8.4.3. If the auditor has identified events that require adjustment to comply with the entity's applicable financial reporting framework, the auditor shall determine whether each such event is appropriately reflected in the financial statements.
- 8.4.4. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report or after the financial statements have been issued. However, if the auditor becomes aware of facts or events that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall discuss with management, and where appropriate, those charged with governance, and determine whether the financial statements need amendment:

- (a) After the date of the auditor's report but before the financial statements are issued, or
- (b) After the financial statements have been issued.

## 8.5. The Auditor's Evaluations and Other Activities to Support the Auditor's Conclusion

### *Evaluations Required*

8.5.1. Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate whether the assessments of the risks of material misstatement at the financial statement and assertion levels remain appropriate.

*An audit of financial statements is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing or extent of planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. In such circumstances, the auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the classes of transactions, account balances, or disclosures and related assertions.*

*The auditor may also consider whether such information changes the auditor's determination about the appropriateness of use of the ISA for LCE for the audit.*

8.5.2. For accounting estimates, the auditor shall evaluate, based on the audit procedures performed and audit evidence obtained, whether:

- (a) The assessments of the risks of material misstatement at the assertion level remain appropriate, including when indicators of possible management bias have been identified;
- (b) Management's decisions about the recognition, measurement, presentation and disclosure of accounting estimates in the financial statements are reasonable in the context of the applicable financial reporting framework; and
- (c) Sufficient appropriate audit evidence has been obtained.

8.5.3. The auditor shall evaluate whether two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor shall evaluate the effect, if any, on the audit and take action as appropriate.

*For example, the original risk assessments may need to be revised, the auditor's opinion may need to be modified on the basis of a scope limitation or other actions as appropriate.*

8.5.4. The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework. In making this evaluation, the auditor shall consider whether the financial statements are presented in a manner that reflects the appropriate:

- (a) Classification and description of financial information and the underlying transactions, events and conditions; and
- (b) Presentation, structure and content of the financial statements

### Concluding

- 8.5.5. The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to be corroborative or contradictory to other information obtained.
- 8.5.6. If the auditor has not obtained sufficient appropriate audit evidence as to a relevant assertion, the auditor shall attempt to obtain additional audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements.
- 8.5.7. The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.
- 8.5.8. The auditor shall conclude, based on the audit evidence obtained, whether in the auditor's professional judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for:
- (a) In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or
  - (b) In the case of a compliance framework, the financial statements not to be misleading.
- 8.5.9. If the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud, the auditor shall evaluate the implications on the audit including on the assessed risks of material misstatement and the auditor's report.

### 8.6. Written Representations

*Written representations are necessary information that the auditor requests in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. However, although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.*

- 8.6.1. The auditor shall request written representations from management, who have appropriate knowledge of the matters concerned and responsibility for the financial statements, and where appropriate, those charged with governance about the following matters:
- (a) That they have fulfilled their responsibility for the preparation of the financial statement in accordance with the applicable financial reporting framework, including where relevant their fair presentation;

- (b) That they have provided the auditor with all relevant information and access as agreed in the terms of the audit engagement;<sup>7</sup>
- (c) That all transactions are recorded and are reflected in the financial statements;
- (d) That they acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud;
- (e) That they have disclosed to the auditor the result of its assessment of the risk that the financial statements may be materially misstated because of fraud;
- (f) That their knowledge of fraud, or suspected fraud, or allegations of fraud or suspected fraud has been disclosed to the auditor;
- (g) That they have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware;
- (h) That they have appropriately accounted for and disclosed related party relationships and transactions in accordance with the requirements of the financial reporting framework;
- (i) That all known instances of non-compliance or suspected non-compliance with law or regulation whose effects should be considered when preparing financial statements have been disclosed to the auditor;
- (j) That all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework;
- (k) With regard to accounting estimates, whether the methods, significant assumptions and data used in making the accounting estimates and disclosures are appropriate to achieve recognition, measurement or disclosure is in accordance with the applicable financial reporting framework;
- (l) That all events occurring subsequent to date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed;
- (m) With regard to going concern, if a material uncertainty exists, information about their plans for future actions and the feasibility of these plans; and
- (n) Other representations the auditor determines necessary to support other audit evidence in the financial statements, including where necessary to support oral representations.

8.6.2. The written representation shall be in the form of a representation letter addressed to the auditor. Appendix 6 sets out an example management representation letter.

*If management's responsibilities are clearly defined in law or regulation, the auditor may determine not to obtain written representation about those matters already addressed.*

8.6.3. The auditor shall request a written representation from management, and where appropriate, those charged with governance, whether they believe the effects of uncorrected misstatements are

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<sup>7</sup> The management representation shall be described in the same way as described in the terms of engagement.

immaterial, individually or in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

8.6.4. If the auditor has concerns about the competence, integrity, ethical values, or diligence of management, or about its commitment to or enforcement of these, or representations received are inconsistent with other audit evidence, the auditor shall determine the effect on audit evidence more generally and take appropriate actions, including considering the possible effect on the opinion in the auditor's report.

8.6.5. If management does not provide one or more of the requested written representations, the auditor shall:

- (a) Discuss the matter with management.
- (b) Reevaluate the integrity of management and evaluate the effect this may have on the reliability of oral and written representations and audit evidence in general; and
- (c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

8.6.6. The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements. The written representations shall be for all financial statements and period(s) referred to in the auditor's report.

## **8.7. Taking Overall Responsibility for Managing and Achieving Quality**

8.7.1. Prior to dating the auditor's report, the engagement partner shall determine whether:

- (a) There has been sufficient and appropriate involvement by the engagement partner such that the engagement partner has the basis for determining that significant judgments made and conclusions reached are appropriate given the nature and circumstances of the engagement.
- (b) Relevant ethical requirements, including those related to independence, have been fulfilled.
- (c) Overall responsibility for managing and achieving quality on the audit engagement has been taken including the consideration of the firm's related policies and procedures.

8.7.2. Prior to dating the auditor's report, the engagement partner shall review the financial statements and the auditor's report to determine that the auditor's report being issued is appropriate in the circumstances.

## **8.8. Specific Communication Requirements**

8.8.1. The auditor shall communicate all misstatements accumulated during the audit with the appropriate level of management, and as appropriate, those charged with governance, unless prohibited by law or regulation.

8.8.2. The auditor shall communicate to those charged with governance:

- (a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
- (b) Significant difficulties, if any, encountered during the audit.

- (c) Significant matters arising during the audit that were discussed, or subject to correspondence, with management.
- (d) Significant findings from the audit. If, in the auditor's professional judgment, oral communications would not be adequate this communication shall be in writing.
- (e) Any other matters, not already reported, related to fraud that may be relevant to the responsibilities of those charged with governance, unless prohibited by law or regulation.
- (f) Circumstances, if any, that affect the form and content of the auditor's report.
- (i) Written representations the auditor is requesting.
- (j) Any other significant matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

8.8.3. The auditor shall communicate to those charged with governance significant matters arising during the audit in connection with the entity's related parties.

8.8.4. In regard to uncorrected misstatements, the auditor shall communicate:

- (a) Uncorrected misstatements (identified individually) and the effect that they, individually or in aggregate, may have on the auditor's opinion, unless prohibited by law or regulation.
- (b) The effect of uncorrected misstatements from prior periods on the current year financial statements.

8.8.5. Unless all those charged with governance are involved in managing the entity, the auditor shall communicate events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:

- (a) Whether the events or conditions constitute a material uncertainty;
- (b) Whether management's use of the going concern basis of accounting is appropriate in the preparation of the financial statements;
- (c) The adequacy of related disclosures in the financial statements; and
- (d) Where applicable, the implications for the auditor's report.

## 8.9. Specific Documentation Requirements

8.9.1. In addition to the general documentation requirements (Part 2.5.) for an audit engagement, the auditor shall include the following in the audit documentation:

- (a) Agreeing or reconciling the information in the financial statements with the underlying accounting records, including disclosures.
- (b) The amount below which misstatements would be regarded as clearly trivial, all misstatements accumulated during the audit and the auditor's conclusion on the uncorrected misstatements.
- (c) The nature and scope of, and conclusions from, consultations undertaken during the audit, including how such conclusions were implemented.

- (d) If relevant, any new or additional audit procedures or conclusions after the date of the auditor's report, including:
  - (i) The circumstances encountered;
  - (ii) The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and
  - (iii) When and by whom the resulting changes to audit documentation were made and reviewed.

8.9.2. The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

*An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process if they are administrative in nature.*

8.9.3. After assembly of the final audit file is complete, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.

*For example, documentation should not be removed for a period of 5 years.*

8.9.4. If the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor shall, regardless of the nature of the modifications or additions, document:

- (a) The specific reasons for making them; and
- (b) When and by whom they were made and reviewed.

## **9. Forming an Opinion and Reporting**

### *Content of this Part*

Part 9 sets out the requirements for:

- Forming an opinion;
- The types of audit opinions; and
- The content of the auditor's report.

### *Scope of this Part*

Appendix 7 sets out an example unmodified auditor's report and Appendix 8 sets out an example unmodified auditor's report with a material uncertainty related to going concern. Examples of other modified opinions and other matter paragraphs can be found in [the supporting guide]. Further detailed examples of auditor's reports can be found in the 700-series in the International Standards on Auditing.

### **9.1. Objectives**

9.1.1. The objectives of the auditor are to:

- (a) Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained and to express clearly that opinion through a written report; and
- (b) Consider whether there is a material inconsistency between the other information, if any, and the:
  - (i) Financial statements; and
  - (ii) Auditor's knowledge obtained in the audit.

### **9.2. Forming an Opinion on the Financial Statements**

9.2.1. The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

9.2.2. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:

- (a) Whether sufficient appropriate audit evidence has been obtained;
- (b) Whether uncorrected misstatements, individually or in aggregate are material; and
- (c) The evaluations required by paragraphs 9.2.3. to 9.2.6.

9.2.3. The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

9.2.4. In performing the evaluation in paragraph 9.2.3., the auditor shall evaluate, in view of the applicable financial reporting framework:

- (a) Whether the financial statements disclose the entity's significant accounting policies, and whether they have been presented in an understandable way;
- (b) Whether the entity's accounting policies are applied consistently and are appropriate;
- (c) The accounting estimates and related disclosures made by management are reasonable;
- (d) Whether the identified related party relationships and transactions have been appropriately accounted for, presented and disclosed in accordance with the applicable financial reporting framework;
- (e) The information presented in the financial statements is relevant, reliable, comparable and understandable including whether:
  - (i) The information that should have been included has been included;
  - (ii) Such information is appropriately classified, aggregated or disaggregated, and characterized; and
  - (iii) The overall presentation of the financial statements has been undermined by including information that is not relevant or that obscures a proper understanding of the matters disclosed;
- (f) Whether the financial statements provide adequate disclosures to enable intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- (g) The terminology used in the financial statements is appropriate.

9.2.5. When the financial statements are prepared in accordance with a fair presentation framework, the auditor shall also evaluate whether the financial statements achieve fair presentation. This evaluation shall include consideration of:

- (a) The overall presentation, structure and content of the financial statements; and
- (b) Whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

*The auditor's evaluation about whether the financial statements achieve fair presentation, both in respect of presentation and the disclosures necessary to achieve it, is a matter of professional judgment.*

9.2.6. The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.

### **9.3. Form of Opinion**

9.3.1. The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

*Where the financial reporting framework is a fair presentation framework, as is generally the case for general purpose financial statements, the opinion required is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view. Where the financial reporting framework is a compliance framework, the opinion required is on whether the financial statements are prepared, in all material respects, in accordance with the framework.*

- 9.3.2. If the auditor concludes that the financial statements, as a whole, are not free from material misstatement, or is unable to obtain sufficient appropriate audit evidence, the auditor shall modify the auditor's opinion.
- 9.3.3. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, determine whether to modify the auditor's opinion.
- 9.3.4. When the financial statements are prepared in accordance with a compliance framework, the auditor is not required to evaluate whether the financial statements achieve fair presentation. However, if in extremely rare circumstances the auditor concludes, based on the audit evidence obtained, that such financial statements are misleading, the auditor shall discuss the matter with management and, depending on how it is resolved, shall determine whether, and how, to communicate it in the auditor's report.

#### **9.4. Auditor's Report**

9.4.1. The auditor's report shall be in the following order, in writing and:

- (a) Have a title that clearly indicates that it is the report of an independent auditor.
- (b) Be addressed, as appropriate, based on the circumstances of the engagement.

##### *Auditor's Opinion*<sup>8</sup>

- (c) Express an opinion, which shall be either an unqualified, qualified, an adverse or a disclaimer of opinion and state clearly the opinion as to:
  - (i) Whether the financial statements present fairly, in all material respects, or give a true and fair view in accordance with the relevant financial reporting framework (if the financial statements have been prepared using a fair presentation framework);
  - (ii) Whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework (if the financial statements have been prepared using a compliance framework); and
  - (iii) Where appropriate, whether the financial statements comply with statutory requirements.
- (d) Identify the entity whose financial statements have been audited; identify each financial statement, refer to the notes and significant accounting policies and the date and period of each financial statement covered; and identify the financial reporting framework that has been

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<sup>8</sup> The headings within paragraph 9.4.1 applicable to this footnote are mandatory headings within the auditor's report.

applied in the preparation (including the jurisdiction if the financial statements are not in accordance with financial reporting standards issued by the IASB<sup>9</sup> or IPSASB<sup>10</sup>);

*Basis for Opinion<sup>8</sup>*

- (e) State that the audit was conducted in accordance with the [draft] ISA for LCE.
- (f) Refer to the section of the auditor's report that describes the auditor's responsibilities under the [draft] ISA for LCE.
- (g) Include a statement that the auditor is independent of the entity in accordance with relevant ethical requirements for the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall identify the jurisdiction of origin of the relevant ethical requirements or refer to the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code).
- (h) State whether the auditor believes that the audit evidence obtained is sufficient an appropriate to provide a basis for the auditor's opinion.

*Responsibilities of Management for the Financial Statements<sup>8</sup>*

- (i) Include a section describing management's responsibilities for preparing the financial statements in accordance with the applicable financial reporting framework, and assessing the entity's ability to continue as a going concern and use of the going concern basis of accounting is appropriate, as well as disclose matters related to going concern, if applicable;

*Auditor's Responsibilities for the Audit of the Financial Statements<sup>8</sup>*

- (j) Include a section describing the auditor's responsibilities for the audit of the financial statements in accordance with the [draft] ISA for LCE, either in the body of the auditor's report or in an appendix, and including stating or describing:
  - (i) The objectives of the auditor;
  - (ii) That reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the [draft] ISA for LCE will always detect a material misstatement when it exists;
  - (iii) That misstatements can arise from fraud or error;
  - (iv) That the auditor exercises professional judgment and maintains professional skepticism throughout the audit;
  - (v) An audit by stating the auditor's responsibilities for the audit;
  - (vi) The matters communicated with those charged with governance

*Report on Other Legal and Regulatory Requirements<sup>8</sup>*

- (k) Other reporting responsibilities, if any, shall be addressed in a separate section.

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<sup>9</sup> International Accounting Standards Board

<sup>10</sup> International Public Sector Accounting Standards Board

*Signature of the Auditor, Address and Date of the Auditor's Report*

- (l) Be signed and dated, and name the location in the jurisdiction where the auditor practices. The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:
- (i) All the statements and disclosures that comprise the financial statements have been prepared; and
  - (ii) Those with the recognized authority have asserted that they have taken responsibility for those financial statements.
- (m) If there is other information in the entity's annual report, that the auditor has obtained some or all of the information, include a separate section with a heading "other information."

Appendix 7 sets out an example unmodified auditor's report.

9.4.2. When the financial statements are prepared in accordance with a fair presentation framework, the auditor shall refer to "the preparation and fair presentation of these financial statements" or "the preparation of financial statements that give a true and fair view," as appropriate in the circumstances, in the description of responsibilities for the financial statements in the auditor's report.

9.4.3. The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the auditor's opinion.

**9.5. Modified Opinions**

<i>Nature of Matter Giving Rise to the Modification</i>	<i>Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

9.5.1. When modifying the opinion, the auditor shall provide:

- (a) A qualified opinion when the auditor:
- (i) Having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements;

- (ii) Is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive; or
  - (iii) In the auditor's professional judgment management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate in the circumstances but a material uncertainty exists that is not adequately presented and disclosed in the financial statements.
- (b) An adverse opinion when the auditor concludes, based on the audit evidence obtained, that:
- (i) Misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
  - (ii) In the auditor's professional judgment managements use of the going concern basis of accounting in the preparation of the financial statement is inappropriate.
- (c) A disclaimer of opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to form an audit opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

#### *Other Circumstances Where a Modification is Required*

##### Opening Balances

- 9.5.2. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements, as appropriate.
- 9.5.3. If the auditor concludes, based on the audit evidence obtained, that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not appropriately accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate.
- 9.5.4. If the auditor concludes, based on the audit evidence obtained, that the current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework or a change in accounting policies is not appropriately accounted for or adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion as appropriate.
- 9.5.5. The auditor shall modify the auditor's opinion, as appropriate, if a predecessor auditor's opinion regarding the prior year's financial statements included a modification that remains relevant and material to the current year's financial statements.

##### Other

- 9.5.6. If the auditor identifies or suspects non-compliance with law or regulation that have a material effect on the financial statements:

- (a) If the auditor concludes, based on the audit evidence obtained, that the non-compliance with law or regulation has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion;
- (b) If the auditor is precluded from obtaining sufficient appropriate audit evidence about whether the non-compliance has, or is likely to have occurred, the auditor shall express a qualified opinion or disclaim an opinion on the basis of a limitation on the scope of the audit; or
- (c) If the auditor is unable to determine whether non-compliance with law or regulation has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor's opinion.

9.5.7. If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor shall indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion.

#### *Content of the Auditor's Report When the Opinion Is Modified*

9.5.8. When the auditor modifies the audit opinion, or expresses a qualified, adverse, or disclaimer of opinion, the auditor shall:

- (a) Amend the heading "Basis for Opinion" as appropriate.
- (b) Within the basis for opinion section, include a description of the matter giving rise to the modification.
- (c) Use a heading as appropriate for the modification (e.g., "qualified opinion").

#### *Qualified Opinion*

9.5.9. When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section.

9.5.10. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion.

#### *Adverse Opinion*

9.5.11. When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:

- (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
- (b) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

### *Disclaimer of Opinion*

9.5.12. When the auditor disclaims an opinion, the auditor's report shall:

- (a) State that the auditor does not express an opinion on the accompanying financial statements;
- (b) Refer to any other matters or emphasis of matter paragraphs to which the auditor draw attention without qualifying the audit opinion;
- (c) State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- (d) Amend the statement which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

### **9.6. Other Paragraphs in the Auditor's Report**

*Emphasis of Matter paragraphs and Other Matter paragraphs in the auditor's report are used when the auditor considers it necessary to:*

- (a) *Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or*
- (b) *Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.*

### *Emphasis of Matter Paragraphs*

9.6.1. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to the users' understanding of the financial statements, and the auditor would not be required to modify the opinion, the auditor shall include an Emphasis of Matter paragraph in the auditor's report indicating that the auditor's report is not modified in respect of the matter emphasized.

*Examples of where Emphasis of Matter paragraphs may be needed include:*

- (a) *When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.*
- (b) *To alert users that the financial statements are prepared in accordance with a special purpose framework.*
- (c) *When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).*

*The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for:*

- (a) *A modified opinion when required by the circumstances of a specific audit engagement;*

- (b) *Disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or*
- (c) *Reporting when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.*

#### *Other Matter Paragraphs*

9.6.2. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to the users' understanding of the audit, the auditor's responsibilities or the auditor's report the auditor shall include an Other Matter paragraph in the auditor's report provided this is not prohibited by law or regulation.

*The content of an Other Matter paragraph reflects clearly that such other matter is not required to be presented or disclosed in the financial statements. An Other Matter paragraph does not include information that the auditor is prohibited from providing by law, regulation or other professional standards, for example, ethical standards for the confidentiality of information. An Other Matter paragraph also does not include information that is required to be provided by management.*

#### *Material Uncertainty Related to Going Concern*

9.6.3. If the auditor concludes, based on the audit evidence obtained, that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether adequate disclosure about a material uncertainty related to going concern has been made in the financial statements, including:

- (a) That there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business; and
- (b) Management's plans to deal with the events and conditions

In such cases, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Relating to Going Concern (see Appendix 8).

9.6.4. If a "Material Uncertainty Relating to Going Concern" section is required in the auditor's report, the auditor shall:

- (a) Draw attention to the note in the financial statements that discloses the matters related to the material uncertainty; and
- (b) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

9.6.5. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the

applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

9.6.6. If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

9.6.7. If adequate disclosures are not made about a material uncertainty in the financial statements, the auditor shall express a qualified or adverse opinion, as appropriate, and state in the basis for qualified (or adverse) opinion section that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

## **9.7. Comparative Information**

9.7.1. The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. In doing so, the auditor shall evaluate whether:

- (a) The amounts and disclosures in the prior period agree with comparative information or have been restated; and
- (b) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, where changes occurred, have been properly accounted for and adequately presented or disclosed.

9.7.2. If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the prior period financial statements are amended, the auditor shall determine that the comparative information agrees with the amended financial statements.

9.7.3. When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances:

- (a) If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements.
- (b) If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, and the corresponding figures have not been properly restated or appropriate disclosures have not been made, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.
- (c) If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit

evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

9.7.4. When comparative financial statements are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed. When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph.

## 9.8. Other Information

*“Other information” is financial or non-financial information (other than the financial statements and the auditor's report thereon) included in an entity's annual report.*

9.8.1. The auditor shall determine, through discussion with management, which document(s) comprises the annual report, and the entity's planned manner and timing of the issuance of such document(s).

9.8.2. The auditor shall read the other information, and:

- (a) Consider whether there is a material inconsistency between the other information and the financial statements;
- (b) Consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit;
- (c) Respond appropriately when the auditor identifies that such material inconsistencies appear to exist, or when the auditor otherwise becomes aware that other information appears to be materially misstated; and
- (d) Report in accordance with this standard.

9.8.3. As the basis for the considerations in paragraph 9.8.2., the auditor shall, to evaluate their consistency, compare selected amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements) with such amounts or other items in the financial statements. The auditor shall also remain alert for indicators of apparent material misstatements in the remainder of the other information.

*In evaluating the consistency of selected amounts or other items, the auditor is not required to compare all amounts or other items in the other information that are intended to be the same as, or summarize, or to provide greater details about, the amounts or other items within the financial statements, with such amounts or other items in the financial statements.*

9.8.4. If the auditor identifies that a material inconsistency appears to exist (or becomes aware that the other information appears to be materially misstated), the auditor shall discuss the matter with management and, if necessary, perform other procedures to conclude whether:

- (a) A material misstatement of the other information exists;
- (b) A material misstatement of the financial statements exists; or
- (c) The auditor's understanding of the entity and its environment needs to be updated.

9.8.5. If the auditor concludes, based on the audit evidence obtained, that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management:

- (a) Agrees to make the correction, the auditor shall determine that the correction has been made;  
or
- (b) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made. If the correction is still not made, the auditor shall consider the implications for the auditor's report or withdraw from the engagement where this is possible.

9.8.6. The auditor shall document the procedures performed in relation to other information.

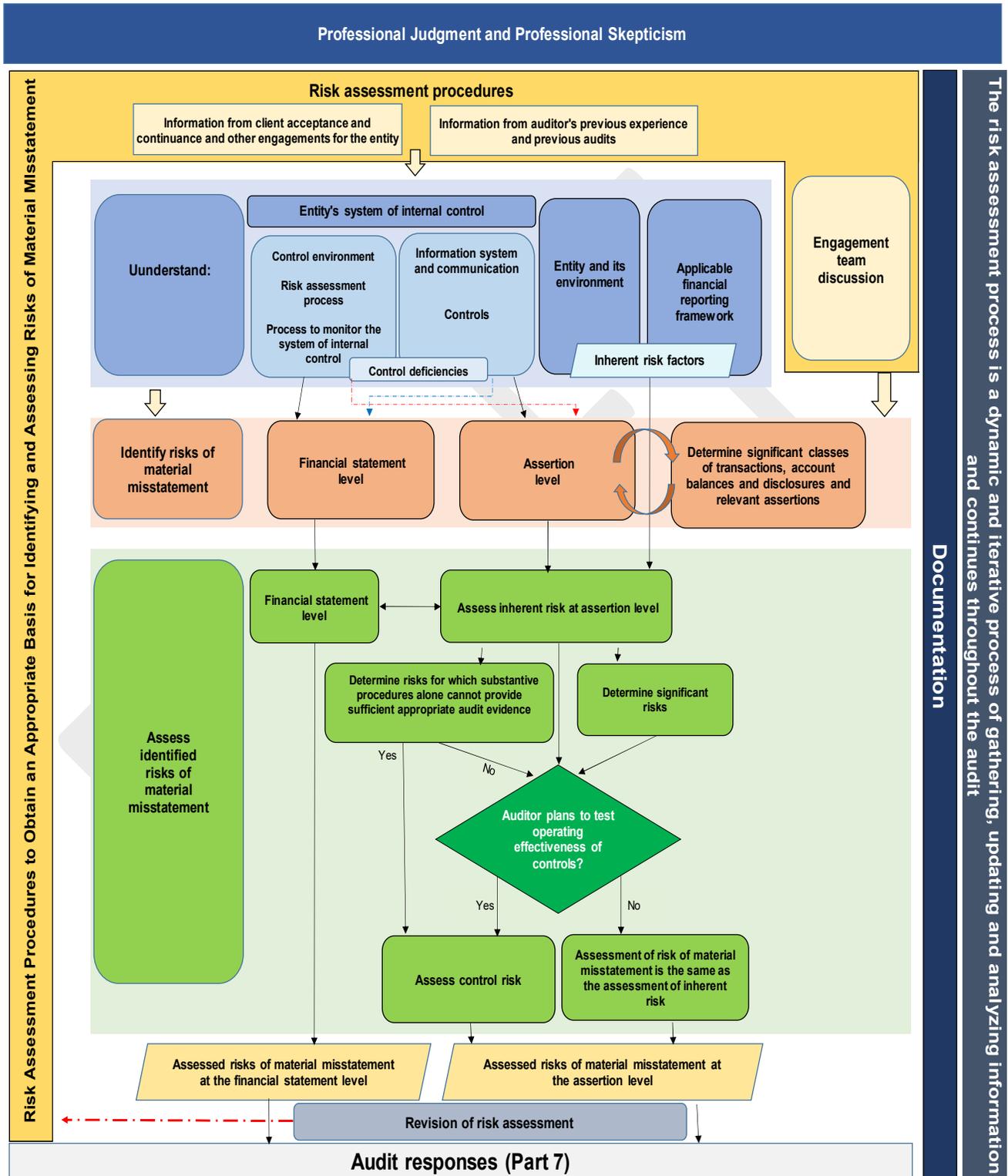
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**Definitions**

[Placeholder for definitions – see **Supplement 1 to Agenda item 2** for a full list of definitions]

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Identifying and Assessing the Risks of Material Misstatement (Part 6)



## Fraud Risk Factors

The fraud risk factors set out below are examples of factors that may be faced by auditors during an audit of less complex entities. Examples are separately presented for the two types of fraud—fraudulent financial reporting and misappropriation of assets.

The risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives/pressures, (b) opportunities, and (c) attitudes/rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different sizes or with different ownership characteristics or circumstances. Also, the order of the examples risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

### Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

#### *Incentives/Pressures*

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

- Significant declines in customer demand or increasing business failures in the industry or overall economy.
- Operating losses causing the threat of bankruptcy or foreclosure.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations.
- Pressure to renew, or obtain additional, financing and therefore to overstate performance or position in order to demonstrate profitability and long-term viability.
- Pressure to understate revenue in order to reduce tax liabilities.

#### *Opportunities*

Opportunities to engage in fraudulent financial reporting that can arise from related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.

- The monitoring of management is not effective, as a result of the domination of management by a single person or small group (in a non owner-managed business) without compensating controls.
- Internal control components are deficient as a result of the following:
  - Limited segregation of duties or anti-fraud controls (e.g., fraud hotlines, internal audit function, etc.)
  - Inadequate monitoring of controls.
  - Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

#### *Attitudes/Rationalizations*

- Poor communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards
- The owner-manager makes no distinction between personal and business transactions.

- Dispute between shareholders in a closely held entity.
- Recurring attempts by management or owners to justify marginal or inappropriate accounting on the basis of materiality or to help the company survive.
- The relationship between management and the current or predecessor auditor is strained by disputes, unreasonable demands on the auditor, restrictions on access to people or information, or domineering management behavior.

### **Risk Factors Arising from Misstatements Arising from Misappropriation of Assets**

Some of the risk factors related to misstatements arising from fraudulent financial reporting may also be present when misstatements arising from misappropriation of assets occur, which often is a common fraud in less complex entities. For example, ineffective monitoring of management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

#### *Incentives/Pressures*

- Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.
- Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example:
- Known or anticipated future employee layoffs.
- Recent or anticipated changes to employee compensation or benefit plans.
- Promotions, compensation, or other rewards inconsistent with expectations.

#### *Opportunities*

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation:

- Large amounts of cash on hand or processed.
- Inventory items that are small in size, of high value, or in high demand.
- Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- Inadequate segregation of duties or independent checks.
- Inadequate system of authorization and approval of transactions (for example, in purchasing).
- Inadequate record keeping or physical safeguards over cash, inventory, or fixed assets.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of information technology.

#### *Attitudes/Rationalizations*

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for internal control by overriding existing controls or failing to take appropriate remedial action on known misappropriations, including petty theft.
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.

## Assertions

**Assertions** are representations, explicit or otherwise, with respect to the recognition, measurement, presentation and disclosure of information in the financial statements which are inherent in management representing that the financial statements are prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing and responding to the risks of material misstatement.

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

An auditor of an LCE may use the following assertions in considering the different types of potential misstatements that may occur. The assertions may fall into the following categories:

*Assertions about classes of transactions and events, and related disclosures, for the period under audit:*

- Occurrence—transactions and events that have been recorded or disclosed have occurred, and such transactions and events pertain to the entity.
- Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
- Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
- Cutoff—transactions and events have been recorded in the correct accounting period.
- Classification—transactions and events have been recorded in the proper accounts.
- 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.

*Assertions about account balances, and related disclosures, at the period end:*

- Existence—assets, liabilities and equity interests exist.
- Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
- Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
- Accuracy, valuation and allocation—assets, liabilities and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.

- Classification—assets, liabilities and equity interests have been recorded in the proper accounts.
- 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.

The assertions described 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.

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## Illustrative Engagement Letter

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with [applicable financial reporting framework]. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in the ISA for LCE. It will need to be varied according to individual requirements and circumstances. It is drafted to refer to the audit of financial statements for a single reporting period and would require adaptation if intended or expected to apply to recurring audits (see paragraph 4.5.2).

\*\*\*

To the appropriate representative of management or those charged with governance of ABC Company:<sup>11</sup>

*[The objective and scope of the audit]*

You<sup>12</sup> have requested that we audit the financial statements of ABC Company, which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the International Standard on Auditing Financial Statements of Less Complex Entities (ISA for LCE) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

*[The responsibilities of the auditor]*

We will conduct our audit in accordance with the ISA for LCE. The ISA for LCE requires that we comply with ethical requirements. As part of an audit in accordance with the ISA for LCE, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Understand internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing

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<sup>11</sup> The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction

<sup>12</sup> Throughout this letter, references to "you," "we," "us," "management," "those charged with governance" and "auditor" would be used or amended as appropriate in the circumstances

concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with the ISA for LCE.

Our audit will be conducted on the basis that [management, and where appropriate, those charged with governance]<sup>13</sup> acknowledge and understand that they have responsibility:

- (a) For the preparation and fair presentation of the financial statements in accordance with [applicable financial reporting framework];<sup>14</sup>
- (b) For such internal control as [management] determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (c) To provide us with:
  - (i) Access to all information of which [management] is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - (ii) Additional information that we may request from [management] for the purpose of the audit; and
  - (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [management, and where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

*[Other relevant information]*

*[Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.]*

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<sup>13</sup> Use terminology as appropriate in the circumstances

<sup>14</sup> Or, if appropriate, "For the preparation of financial statements that give a true and fair view in accordance with [applicable financial reporting framework]"

[Reporting]

[Insert appropriate reference to the expected form and content of the auditor's report including, if applicable, the reporting on other information.]

The form and content of our report may need to be amended in the light of our audit findings.

*Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.*

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

(signed)

.....

Name and Title

Date

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## Illustrative Representation Letter

The following illustrative letter includes written representations that are required by Part 8.6 of the [International Standard for Auditing Financial Statements of Less Complex Entities (the ISA for LCE)]. It is assumed in this illustration that the applicable financial reporting framework is the [applicable financial reporting framework]; the requirement relating to going concern to obtain a written representation are not relevant; and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor)

(Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company for the year ended December 31, 20XX for the purpose of expressing an opinion as to whether the financial statements are presented fairly, in all material respects, (or *give a true and fair view*) in accordance with [applicable financial reporting framework].

We confirm that:

### *Financial Statements*

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [insert date], for the preparation of the financial statements in accordance with [applicable financial reporting framework]; in particular the financial statements are fairly presented (or give a true and fair view) in accordance therewith.
- Significant assumptions used by us in making accounting estimates are reasonable.
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of [applicable financial reporting framework].
- All events subsequent to the date of the financial statements and for which [applicable financial reporting framework] require adjustment or disclosure have been adjusted or disclosed.
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter.
- [Any other matters that the auditor may consider appropriate.]

### *Information Provided*

- We have provided you with:
  - Access to all information of which we are aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
  - Additional information that you have requested from us for the purpose of the audit; and
  - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
  - Management;
  - Employees who have significant roles in internal control; or
  - Others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with law or regulation whose effects should be considered when preparing financial statements.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.
- [Any other matters that the auditor may consider necessary.]

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Management

Management

**Illustrative Auditor's Report (1) – Unmodified Opinion****Unmodified Opinion**

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- **Audit of a complete set of financial statements of an entity (not a listed entity) using a fair presentation framework.**
- **The financial statements are prepared by management of the entity in accordance with the [applicable financial reporting framework] (a general purpose framework).**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial statements in part 4.3 of the ISA for LCE.**
- **The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.**
- **The relevant ethical requirements that apply to the audit are those of the jurisdiction.**
- **There is no other information reported in an annual report.**
- **Those responsible for oversight of the financial statements are the same as those responsible for the preparation of the financial statements.**
- **The auditor has no other reporting responsibilities required under local law. The auditor elects to include the description of the auditor's responsibilities for the audit of the financial statements in the body of the auditor's report.**

## **INDEPENDENT AUDITOR'S REPORT**

To the Shareholders of ABC Company [or Other Appropriate Addressee]

### **Opinion**

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with [applicable financial reporting framework].

### **Basis for Opinion**

We conducted our audit in accordance with the [International Standard for Auditing for Audits of Financial Statements of Less Complex Entities (the ISA for LCE)]. Our responsibilities under the ISA for LCE are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Responsibilities of Management for the Financial Statements<sup>15</sup>**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with [applicable financial reporting framework],<sup>16</sup> and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes

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<sup>15</sup> Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

<sup>16</sup> Where management's responsibility is to prepare financial statements that give a true and fair view, this may read: "Management is responsible for the preparation of financial statements that give a true and fair view in accordance with [applicable financial reporting framework], and for such ..."

our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISA for LCE will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the ISA for LCE, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Understand internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

*[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]*

*[Auditor Address]*

*[Date]*

## Illustrative Auditor's Report (2) – Unmodified Opinion and Material Uncertainty Related to Going Concern

### Unmodified Opinion When a Material Uncertainty Related to Going Concern Exists and Disclosure in the Financial Statements is Adequate

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity (not a listed entity) using a fair presentation framework.
- The financial statements are prepared by management of the entity in accordance with the [applicable financial reporting framework] (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in Part 4.3 of the ISA for LCE.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the jurisdiction.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. The disclosure of the material uncertainty in the financial statements is adequate.
- There is no other information reported in an annual report.
- Those responsible for oversight of the financial statements are the same as those responsible for the preparation of the financial statements.
- The auditor has no other reporting responsibilities required under local law.

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

### Opinion

We have audited the financial statements of ABC Company (the Company), which comprise the statement of financial position as at December 31, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, (or *give a true and fair view of*) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with [applicable financial reporting framework].

### Basis for Opinion

We conducted our audit in accordance with the [International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (the ISA for LCE)]. Our responsibilities under the ISA for LCE are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Material Uncertainty Related to Going Concern

We draw attention to Note X in the financial statements, which indicates that the Company incurred a net loss of xxx during the year ended December 31, 20X1 and, as of that date, the Company's current liabilities exceeded its total assets by xxx. As stated in Note X, these events or conditions, along with other matters as set forth in Note X, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

### Responsibilities of Management for the Financial Statements<sup>17</sup>

Management is responsible for the preparation and fair presentation of the financial statements in accordance with [applicable financial reporting framework],<sup>18</sup> and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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<sup>17</sup> Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

<sup>18</sup> Where management's responsibility is to prepare financial statements that give a true and fair view, this may read: "Management is responsible for the preparation of financial statements that give a true and fair view in accordance with [applicable financial reporting framework], and for such ..."

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISA for LCE will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the ISA for LCE, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Understand internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that

we identify during our audit.

*[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]*

*[Auditor Address]*

*[Date]*

DRAFT



## AUASB Agenda Paper

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<b>Project:</b>	<b>ISA 600</b>	<b>Meeting:</b>	June 2021
<b>Topic:</b>	<b>Revision of Group Audit Standard</b>	<b>Agenda Item:</b>	6.2
<b>Strategic Objective:</b>	Influence international standards and guidance to achieve public interest outcomes and serve as the most effective base possible for Australian auditing and assurance standards	<b>Decision-Making:</b>	For Discussion and AUASB input
<b>ATG Staff:</b>	Rene Herman	<b>Project Status:</b>	IAASB – Exposure Draft ISA for LCE
<b>AUASB Sponsor:</b>	TBA		

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### AUASB Action Required and Decisions to be Made

- 1 The **purpose** of this Agenda Item is to take the **AUASB through the main changes to proposed ISA- 600 since the March 2021 IAASB meeting, as they relate to issues raised by the AUASB in the [AUASB submission to the IAASB on ED-ISA 600](#)**. There is no issues paper presented for this Agenda Item, rather the ATG have prepared a series of slides.
- 2 The ATG provided the AUASB with a detailed update at the March 2021 AUASB meeting (Agenda Item 5.3) on the following areas of the standard:
  - a) Scope/Applicability
  - b) Risk based approach
  - c) Interactions group auditor and component auditor (strengthening 2-way comm)
  - d) Materiality

The updates to each of these areas have addressed the substantive points as raised by the AUASB in the submission to the IAASB on ED-IDA 600 (as reflected in Agenda Item 5.3/March 2021 AUASB meeting). There have been no further substantive changes to the requirements in the above areas, although there have been enhancements made to application material.
- 3 The ATG will take the AUASB through the **slide deck** as presented at Agenda Item 6.2.1 and **seek AUASB input/comment on the areas outlined in the slide deck**. The ATG plan to only take the AUASB through the more substantive changes to the standard as they relate to AUASB issues raised on exposure.
- 4 A hyperlink to the marked-up (since March 2021) proposed ISA-600 is available [\[here\]](#). **It is not expected that AUASB members read the standard at this stage, rather the link has been provided for ease of reference only.**

# ISA 600 Update

## June 2021 AUASB Meeting

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# Agenda

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- Some of the topics for discussion at the June 2021 IAASB meeting **that are linked to AUASB comments** on ED-ISA 600:
  - Review of component auditor’s documentation
  - Sufficiency and appropriateness of audit evidence
  - Documentation
  - Professional scepticism
  - Other more significant changes



# Review of component auditor's documentation

- The requirement to determine whether, and the extent to which, it is necessary to review parts of the component auditor's audit documentation has been expanded (45A):
  - In making this determination, the group auditor shall consider:
    - The nature, timing and extent of the work performed by the component auditor; and
    - The competence and capabilities of the component auditor.
- Application material provides factors that the group auditor may consider (A51/A113)



# Sufficiency and appropriateness of audit evidence

- Application material has been expanded in relation to evaluating the sufficiency and appropriateness of audit evidence from component auditors particularly:
  - New paragraph (A115A):
    - Factors to consider when undertaking stand-back
  - new paragraph (A115B):
    - In some circumstances, an overall summary memorandum or report describing the work performed and the results thereof may provide a basis on its own for the group auditor to conclude that the work performed and audit evidence obtained by the component auditor is sufficient for purposes of the group audit. This may be the case, for example, when the component auditor has been requested to perform specific further audit procedures as identified and communicated by the group auditor.



# Documentation

- The documentation requirements have been significantly expanded. Requirements now include (only showing new requirements):
  - basis for determination that component auditors have appropriate competence and capabilities including sufficient time;
  - Key elements of the understanding of the group’s system of internal control;
  - The nature, timing and extent of the group auditor’s direction and supervision of component auditors and the review of their work, including, as applicable, the group auditor’s review of parts of the component auditor’s audit documentation in accordance with paragraph 45A(see slide 3)



# Professional scepticism

- Exert from AUASB response to ED-ISA 600:
  - The AUASB considers that the exercise of professional scepticism in relation to an audit of group financial statements could be strengthened.
- IAASB proposed response
  - Expanded requirement: stronger linkage to ISA 220: to include the GEP's responsibility for creating an environment for the engagement that emphasises the expected behavior of engagement team members (Para 12)
  - Expanded Application Material



# Main other changes – AUASB issues or significant new requirement

- Applicability of the standard: Additional application material to contrast the situations in which standard applies to a single legal entities
- Access issues:
  - Additional application material on access to information/people
  - Additional application material on non controlling interest in equity investment: noting professional judgement and ROMM(A29A)
- Numerous Individual Components that Are not Individually Financially Significant
  - Additional application material to address situation where group auditor can't perform procedures centrally (A89A)
- Communication with group management:
  - New requirement to communicate overview of group audit plan



# Way Forward

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- Continue to monitor and feed into IAASB process
- September 2021 AUASB meeting:
  - summary of all AUASB matters raised on ED and IAASB resolutions
- December 2021 AUASB meeting:
  - draft standard to be circulated to AUASB for any final fatal flaw comments
- IAASB still working towards a December 2021 completion and approval of final standard





## AUASB Agenda Paper

<b>Project:</b>	IAASB Fraud Project	<b>Meeting:</b>	8 June 2021
<b>Topic:</b>	IAASB Fraud Issues paper	<b>Agenda Item:</b>	6.3.0
<b>Strategic Objective:</b>	International Influence	<b>Decision-Making:</b>	For Update and Discussion
<b>ATG Staff:</b>	Marina Michaelides	<b>Project Status:</b>	In Progress
<b>AUASB Sponsor:</b>	To be Decided		

### Action Required and Decisions to be Made

- 1 The purpose of this Agenda Item is to update the AUASB on the progress made by the IAASB Fraud Working Group on recommended possible actions for each of the topics (informed by the submissions received) to support the development of a final fraud project proposal.
- 2 A link to the IAASB Fraud in an Audit of Financial Statements – Specific Issues paper is provided [[here](#)].

### ATG Recommendations Overview and Questions for the Board

Question No.	Question for the Board	ATG Recommendation Overview
<b>Question 1</b>	Q1. Does the AUASB have any comments or feedback on the views of the Fraud WG on the recommended possible actions for each of the key topic areas that will inform the final fraud project proposal?	Refer Agenda Item 6.3.1 for the Summary Memorandum.

## Background

- 3 The IAASB issued the Fraud and Going Concern Discussion Paper in September 2020 for comment by 1 February 2021 (extended from 12 January 2021).
- 4 The AUASB conducted an Australian Roundtable on the Fraud DP in November 2020 to hear feedback from stakeholders on the areas outlined in the DP.
- 5 The AUASB discussed and finalised their submission to the IAASB at its December 2020 meeting with the final submission received by the IAASB at the end of December 2020.
- 6 The IAASB met via teleconference on 22 April 2021 to
  - (a) Provide an overview of the feedback received to date related to fraud; and
  - (b) Obtain the IAASB's views on the possible direction on the matters identified

There were 85 responses to the IAASB's DP, overall feedback from respondents to the DP and input from other information gathering activities indicates that a fundamental revision of ISA 240 is not needed. However, there are targeted areas where enhancements to requirements or application material may be beneficial. Respondents emphasised the importance of all stakeholders in the financial reporting ecosystem. This overall theme was supported by IAASB members.

The purpose of the IAASB discussion was to inform whether the IAASB will proceed to develop a project proposal and if so, help identify and prioritise the matters that should be considered for inclusion in the project proposal. IAASB members were largely supportive of the possible actions being explored further as part of a project proposal however encouraged the working group to really focus on the main public interest areas which could lead to improved outcomes while considering a cost/benefit analysis. The main public interest standard setting potential areas largely fall into the following 4 categories: linkages to other standards, highlighting the importance of professional scepticism, enhancements in relation to auditor communications and modernisation of the standard to reflect technology.

- 7 The UK FRC has issued revised ISA (UK) 240 (Revised May 2021) *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* on 27 May 2021. The revisions are designed to provide increased clarity as to the auditor's obligations, addressing the concern raised by the Brydon review of the quality and effectiveness of audit. The revisions include enhancements to the requirements for the identification and assessment of risk of material misstatement due to fraud and the procedures to respond to those risks. These revisions do not address Brydon recommendations around controls and detection of fraud that may impact audit reporting. These will be dealt with separately by the UK FRC in the context of the overall auditor's report.

## Previous Discussions on Topic

- 8 See above.

## 9 Matters for Discussion

- A The table at Agenda item 6.3.1 illustrates the recommended possible actions, which have been mapped to the AUASB submission on the DP. Since April, six areas (# 4,12,13,15,18 and

20) have been further progressed by the IAASB Fraud WG. See the table for comments on these areas. The remaining six areas are still to be considered by the IAASB at its July 2021 teleconference.

## **Other matters for noting**

10 None noted.

## **Collaboration with NZAuASB and other standard setters**

11 The AUASB will continue to work with the NZAuASB on this important IAASB project as they progress towards a final project plan for approval at its September 2021 meeting.

## **Next steps/Way Forward**

12 The ATG will continue to monitor developments on this project.



**Australian Government**  
**Auditing and Assurance Standards Board**

	AUASB Theme Identified in submission on Discussion paper	Issue/Theme identified by IAASB through all stakeholder submissions	Standard -Setting - Introduction	Standard-Setting - Requirements	Standard-Setting – App. Material	Non-Authoritative Guidance	Education	Actions for Others	Further WG and Board Discussion Needed <sup>1</sup> / No Further Action
1	Importance of corporate culture and in-depth knowledge of the entity. Consideration of links between exec incentives.	Stronger Linkages to Risk Identification and Assessment (ISA 315 (Revised 2019))		X	X	X			
2	What is required when fraud is detected and consideration of links between ISA 250 and ISA 260	Enhanced Transparency with TCWG and Enhanced Linkage to ISA 260		X	X				
3	Not raised by AUASB	Closer or Enhanced Linkage to ISA 550 <sup>2</sup>		X	X	X			
4	Closer links to ISA 540 and management bias. No support for suspicious mindset.	Enhancements to Professional Skepticism; and  Suspicious Mindset Concept		X	X	X			X <sup>3</sup>
5	Consideration of use of emerging technologies and modernization of the standard.	Journal Entry Testing		X	X	X			
6	Consideration of use of emerging technologies and modernization of the standard.	Technology			X	X			

<sup>1</sup> The working group considers that further investigation is needed to come back to the IAASB with more detail.

<sup>2</sup> This was not well supported by the IAASB members at the April 2021 teleconference on the basis that the related parties standard addresses fraud risk.

<sup>3</sup> The working group recommends not pursuing the concept of a suspicious mindset but rather recommends possible actions to enhance and emphasize the existing concept of professional scepticism.

7	No additional procedures necessary	Non-Material Fraud and Linkage to ISA 320 <sup>4</sup>		X	X	X			
8	More guidance on how unpredictable audit procedures address fraud risk	Unpredictability Procedures			X	X			
9	Not raised by AUASB	Audit Documentation and Closer or Enhanced Linkage to ISA 230 <sup>5</sup>		X	X	X			X <sup>6</sup>
10	Consideration of use of emerging technologies and modernization of the standard.	Analytical Procedures and Closer or Enhanced Linkage to ISA 520 <sup>7</sup>		X	X	X			
11	Somewhat touched upon by AUASB: involvement of more senior team members along with effective supervision and review (ISQM 1 and ISA 220 related)	Linkage to Other ISAs (those not already referenced in other categories) <sup>8</sup>		X	X	X			
12	Not strong support but support to use as part of team discussions and ultimately based on circumstances.	Forensic Specialists		X <sup>9</sup>	X	X			
13	Further consideration of what is needed to help clarify the auditor's responsibilities.	Definition of Fraud <sup>10</sup>			X	X	X		X <sup>11</sup>
14	Mixed views around more transparency however consideration of improved transparency by management and TCWG.	Enhanced Transparency in the Auditor's Report							X

<sup>4</sup> Working group not recommending scope expansion but rather enhancements to clarify auditor's responsibilities/further actions when a possible non-material fraud is identified.

<sup>5</sup> Consideration of whether additional fraud related documentation is needed.

<sup>6</sup> This category will remain open as the project progresses because the WG will further consider whether specific documentation requirements are needed for any enhancements proposed.

<sup>7</sup> Consideration of appropriate level of disaggregation at planning/closing stages. Consideration of non-authoritative guidance with technology working group when using ATT when performing analytical procedures.

<sup>8</sup> Including ISA 220, ISQM 1, ISA 330, ISA 610, ISA 265.

<sup>9</sup> Consideration whether the IAASB should pursue standard setting to require the use of forensic specialists, and in what circumstances or whether there is another appropriate action to address the issues identified.

<sup>10</sup> Further exploration and further consideration of what is needed to clarify the auditor's responsibilities.

<sup>11</sup> The IAASB is asking for feedback on whether application material or non-auth guidance is preferred to clarify how other concepts often associated with fraud (bribery and corruption) interact with the concept of fraud for the purposes of the financial statement audit.

15	Not raised by AUASB	Revisit Introductory Language in ISA 240 About Inherent Limitations of an Audit	X (ISA 240) <sup>12</sup>		X (ISA 200)		X		
16	Knowledge share by senior team members	Making the Fraud Brainstorming (Engagement Team Discussion) More Robust		X	X				X
17	What is required when fraud is detected and consideration of links between ISA 250 and ISA 260	Clarifying the Relationship Between ISA 240 and ISA 250 (Revised)							X
18	Improvements to identify fraud risk factors beyond revenue and journal entries – including practical case studies.	Rebuttable Presumption of Fraud Risk in Revenue Recognition and Related Issues <sup>13</sup>			X	X			
19	What is required when fraud is detected and consideration of links between ISA 250 and ISA 260	Requirements for when Fraud is Detected or Identified							X
20	Not raised by AUASB	External Confirmations and Closer or Enhanced Linkage to ISA 505 <sup>14</sup>			X	X			
21	AUASB supports activities which further consider issues such as cyber controls.	Third-Party Fraud <sup>15</sup>				X	X		
22	Role of Education and professional training requirements	Education					X	X	
23	Whole of financial reporting ecosystem issue – mgmt and TCWG role to implement and manage governance, culture and risk management	Importance of the Role of All Stakeholders in the Financial Reporting Ecosystem						X	X

<sup>12</sup> Consideration of re-ordering the introduction paragraphs so that auditor responsibilities are presented prior to addressing inherent limitations of an audit. Explore if possible, enhancements can be made to clarify auditor's responsibilities in relation to fraud.

<sup>13</sup> Consideration on whether to highlight other areas susceptible to material misstatement due to fraud and clarify when it may be appropriate to rebut presumption of risks of fraud and how this can be done.

<sup>14</sup> Consideration and implications where external confirmations are not reliable or not received, consideration with technology WG on the advent of open banking where the auditor can directly obtain audit evidence.

<sup>15</sup> Working group will collaborate with technology working group.



Australian Government

Auditing and Assurance Standards Board

AUASB June 2021  
Agenda Item 8.1

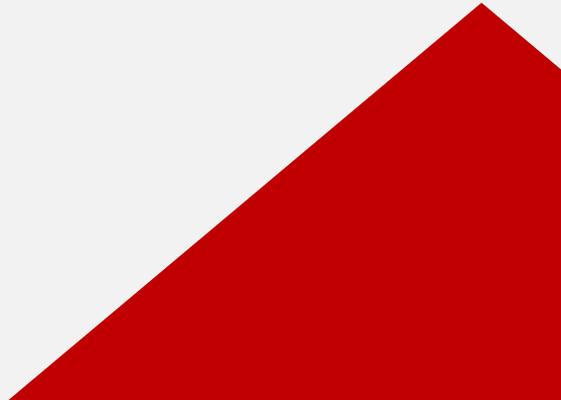
June 2021

June 2021 AUASB Meeting

# AUASB Work Program Update



Completed  
Projects  
YTD

- Updated Auditor Responsibility Statements
  - ASRE 2410
  - COVID-19 Guidance on AUASB Website
  - AUASB/UNSW Going Concern Roundtable
  - GS 012
  - ASRS 4400 (Agreed Upon Procedures)
  - AUASB Due Process Framework Document
  - Research Report on COVID-19 impact on Listed Audit Reports
  - PJC Inquiry - Response to final report
  - Response to IAASB Discussion Paper on Fraud and Going Concern
  - Auditor Reporting Post Implementation Review Survey
  - Audit Committee Chairs Audit Quality Survey
  - Assurance Framework Publication - Guide for Prescribers
  - ASA 540 Implementation Support
  - AUASB Foreword to Pronouncements
  - AUASB/NZAuASB Conformance and Harmonisation Policy
  - Quality Management Standards (ASQM 1, ASQM 2, ASA 220)
  - Guidance for Auditors on removal of SPR for 'For Profit' entities
  - CA ANZ Audit Conference Presentations
  - Feedback to APESB on IESBA's proposed revised PIE Definition
  - AUASB Digital Standards Portal
  - AUASB Bulletin on Cybersecurity implications for Auditors
- 

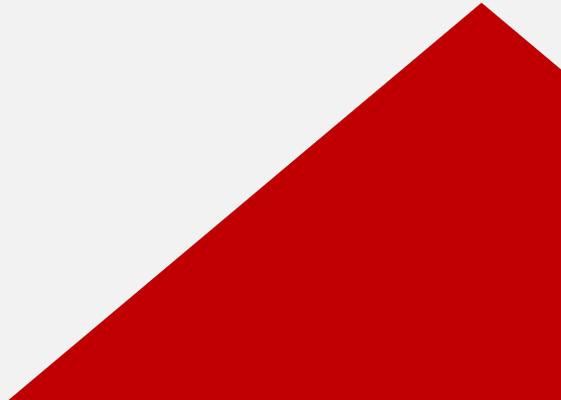


Projects  
currently in  
Progress

## **Domestic**

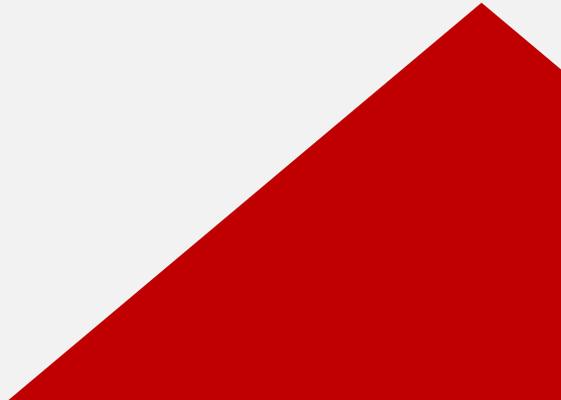
- EER Guidance - AUASB Bulletin
- AUASB Preamble
- Audit Engagement Disclosures
- Technology PAG – Data Integrity Guidance
- ASA 315 Implementation Plan
- Quality Management Standards Implementation Plan
- Updates to ASA 560 Subsequent Events
- ASA Compilations for ASA 315
- Public Sector PAG
- Technology PAG

## **International**

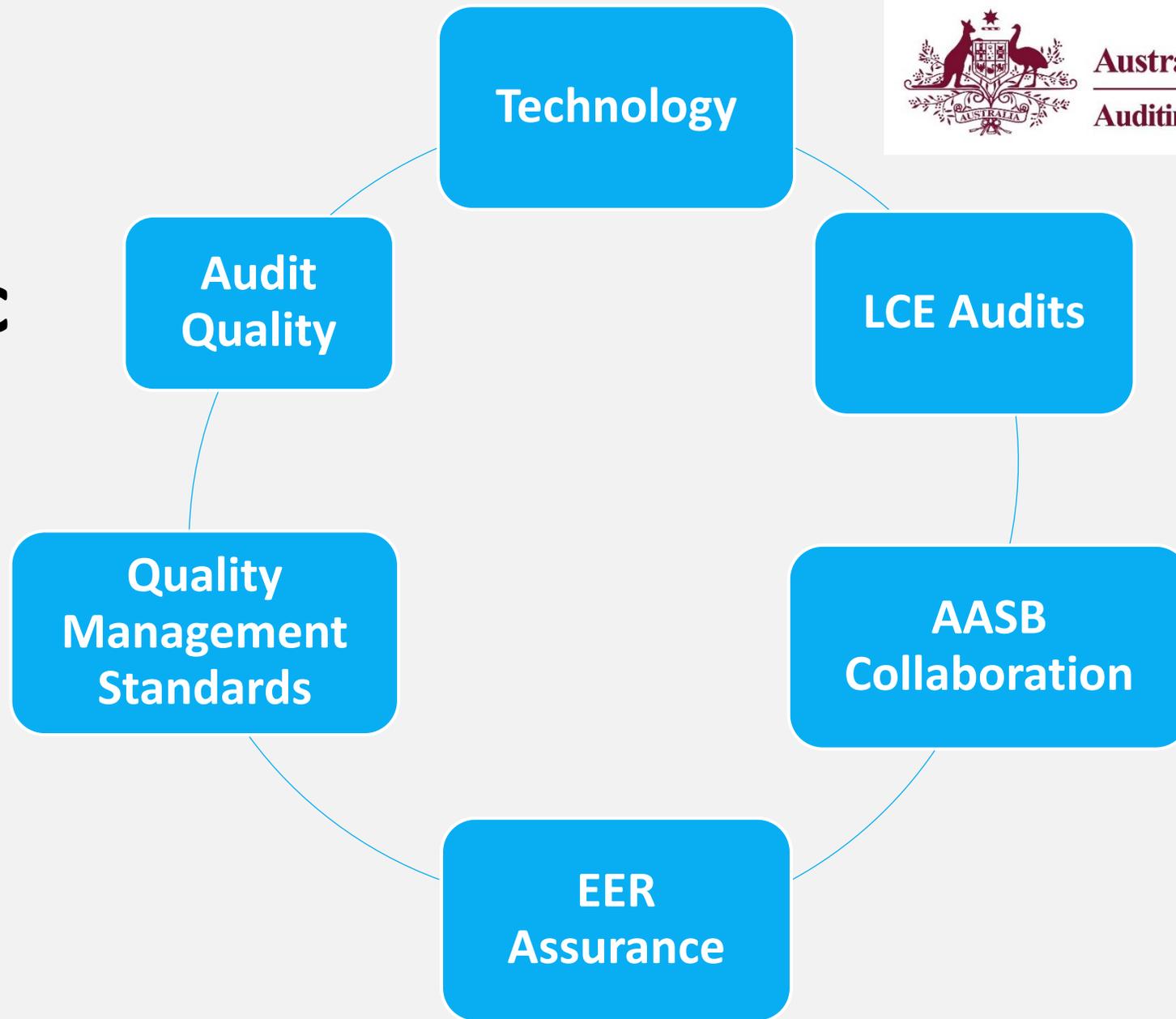
- ISA 600 - New Group Audits Standard
  - LCE/CUSP
  - Fraud
  - Going Concern
  - Audit Evidence
  - IAASB 2022-23 Work Plan Consultation
- 



Projects yet to  
commence

- Auditor Reporting Post Implementation Review
  - Less Complex Entities - AU implications
  - GS 010 (Questions at AGMs)
  - GS 016 (Bank Confirmations)
  - GS 007 (Service Organisations)
  - Post Implementation Reviews of ASAE 3100 and 3500
  - GS 003 (AFSLs)
  - GS 011 (Access to Workpapers)
  - Update of Corporate Fundraisings Standard (with NZAuASB)
  - ASA 800 (alignment with new AASB standards)
- 

# Current AUASB Strategic Priority Areas



Other topics to  
consider for  
2021-22 Work  
Program?

- Sustainability Reporting / Climate Change
- Deregulation/ Red Tape reduction opportunities
- Charities / Not for Profits
- Further outreach on PJC recommendations (e.g. Going Concern, Fraud)
- Review Engagements
- Others????



## AUASB Agenda Paper

<b>Project:</b>	<b>IAASB Workplan 2022-23</b>	<b>Meeting:</b>	June 2021
<b>Topic:</b>	<b>Feedback on IAASB Priorities for 2022-23</b>	<b>Agenda Item:</b>	8.2
<b>Strategic Objective:</b>	Influence international standards and guidance to achieve public interest outcomes and serve as the most effective base possible for Australian auditing and assurance standards	<b>Decision-Making:</b>	For Discussion and AUASB input
<b>ATG Staff:</b>	Matthew Zappulla	<b>Project Status:</b>	In progress
<b>AUASB Sponsor:</b>	Bill Edge		

### AUASB Action Required and Decisions to be Made

- 1 The IAASB are seeking input on their 2022-23 Work Plan via completion of a Survey by stakeholders by 5 August 2021. The AUASB is requested for feedback so the AUASB Technical Group staff can compile the AUASB's response to the IAASB's Work Plan Survey. Full details of the IAASB consultation can be found on the IAASB website [here](#).
- 2 The IAASB are seeking stakeholder views about what topic(s) should be considered for future standard-setting or other IAASB activities. They have indicated that it is likely that one, or possibly two, new topics could be pursued over this period, and have developed a short list of eight (8) possible topics from which these new projects could be derived. These 8 topics are listed below and the AUASB is requested to provide their views on which of these topics should be a priority for the IAASB in order to rank them as part of our survey response:

Topic	Description
<b>Responding to Assessed Risks</b>	Revising and modernizing ISA 330, <i>The Auditor's Responses to Assessed Risks</i> to enhance the coherence of the suite of ISAs and make the standard more relevant for today's environment and current practice. A project to revise ISA 330 would likely require a substantial revision project.

# AUASB Agenda Paper

Topic	Description
<b>Analytical Procedures</b>	Revising ISA 520, <i>Analytical Procedures</i> to enhance the relevance of the standard for today's environment (e.g., taking into account the impact of technology on how analytical procedures are planned and performed), to address regulatory concerns, enhance the coherence of the suite of ISAs and address other challenges identified with the standard. Activities to scope a project on ISA 520 would determine whether it would be a substantial revision of the standard or more limited in scope, or whether the development of non-authoritative guidance is needed.
<b>Audit Sampling</b>	Revising ISA 530, <i>Audit Sampling</i> to enhance the relevance of the standard for today's environment (e.g., for consistency in practice), respond to regulatory concerns and address other challenges identified with the standard. Activities to scope a project on ISA 530 would determine whether it would be a substantial revision of the standard or more limited in scope, or whether the development of non-authoritative guidance is needed.
<b>Using the Work of an Auditor's Expert</b>	Revising ISA 620, <i>Using the Work of an Auditor's Expert</i> to enhance the relevance of the standard for today's environment (e.g., new practice and behaviors regarding using experts), respond to regulatory input and address other matters of clarity needed. Activities to scope a project on ISA 620 would determine whether it would be a substantial revision of the standard or more limited in scope.
<b>Review of Interim Financial Information</b>	Revising International Standard on Review Engagements (ISRE) 2410, <i>Review of Interim Financial Information Performed by the Independent Auditor of the Entity</i> for the Clarity format for coherence with other IAASB standards, enhance clarity and address other challenges identified related to the standard. A project to revise ISRE 2410 would likely require a substantial revision project.
<b>Joint Audits</b>	As joint audits are becoming more prevalent globally there is an increasing need for guidance about how joint audit engagements should be undertaken; clarifying practice in this area will contribute to consistency in auditor procedures. Initially, we could explore whether it is feasible to develop a pronouncement or non-authoritative materials that would have global relevance due to the differing nature of such engagements in those jurisdictions where joint audits are mandated or permitted, to determine an appropriate way forward.
<b>Assurance for XBRL</b>	The increasing use of eXtensible Business Reporting Language (XBRL) in digital financial reporting, for example by the Securities and Exchange Commission in the United States, the European Union, will likely drive the need for assurance in this area in the near future. We could explore the development of an assurance standard for assurance engagements on financial information reported in a digital format that would meet global needs.

# AUASB Agenda Paper

Topic	Description
<b>Assurance for Climate Change Disclosures</b>	Climate change disclosures continue to evolve globally, as does the need for assurance. We could explore the development of an assurance standard or non-authoritative guidance for assurance engagements on climate change disclosures that would meet global needs.

3 Based on current or past AUASB projects and areas of strategic priority the AUASB Technical Group applied a series of criteria to determine an initial prioritisation of these possible IAASB projects. The criteria used were:

- (a) Is the topic aligned with the AUASB's current strategic priorities.
- (b) Is the topic an issue that has been raised as an area of focus in our recent consultation with stakeholders (including Regulators).
- (c) How current or out of date is the existing standard related to the topic (if applicable).

4 Accordingly, the AUASB Technical Group has ranked the proposed IAASB topics in the following order of priority:

Ranking	Topic	Comments
1	Review of Interim Financial Information	<i>Aligned with AUASB's update of ASRE 2410</i>
2	Responding to Assessed Risks	<i>Needed to complement recent update to ASA 315</i>
3	Analytical Procedures	<i>Existing standards very out of date, especially with developments in use of Technology</i>
4	Audit Sampling	
5	Assurance for Climate Change Disclosures	<i>Further work to complement recent EER guidance a good idea.</i>
6	Assurance for XBRL	<i>Whilst an interesting topic not an issue that has been raised a major concern through our Technology PAG</i>
7	Joint Audits	<i>Joint Audits not commonly applied in Australia</i>
8	Using the Work of an Auditor's Expert	<i>Already addressed in recent update of GS 005 and no issues raised with current ASA 620</i>

5 **AUASB members are asked for their feedback about whether they agree with the preliminary ranking of each topic above, and if there are other topics the IAASB should also consider addressing as part of the AUASB's 2022-23 Work Plan survey response.**



## AUASB Agenda Paper

<b>Project:</b>	<b>Public Sector Audit Issues</b>	<b>Meeting:</b>	<b>8-9 June 2021</b>
<b>Topic:</b>	<b>Public Sector Audit Issues</b>	<b>Agenda Item:</b>	<b>9.0</b>
<b>Strategic Objectives:</b>	1 & 2	<b>Decision-Making:</b>	For Noting
<b>ATG Staff:</b>	Matthew Zappulla Johanna Foyster	<b>Project Status:</b>	In Progress
<b>AUASB Sponsor:</b>	Julie Crisp		

### Objective of Agenda Item

- 1 Report to the AUASB on the progress of the Public Sector Audit Issues Project Advisory Group (PAG).

### Action Required and Decisions to be Made

- 2 This Agenda Item is for noting and there are no specific actions for the AUASB.

### Background

- 3 The AUASB approved a Strategic Project Plan focusing on Public Sector Audit Issues at its April 2018 meeting.
- 4 The PAG Terms of Reference (TOR) and Membership were confirmed at the first meeting of the PAG in March 2019 (refer to April 2019 AUASB meeting papers - Agenda Item No. 9).
- 5 The PAG met on four occasions during 2019 and the AUASB received regular updates at its meetings on the PAG's progress during this period. The last update to the Board was at its December 2019 meeting (refer to Agenda Item No. 15).
- 6 The project was paused early in 2020 due to the AUASB reallocating resources to respond to higher priority issues related to the COVID-19 pandemic and to finalise other major projects.

### Matters to Consider

- 7 The PAG reconvened in April 2021 to re-affirm the membership and the TOR for the PAG (updated to reflect technical staff changes and new timelines) and to chart the way forward.
- 8 The PAG re-affirmed the three top priorities identified in its TOR, namely: Terms of Engagement, Going Concern and Engagement Leader responsibilities. Once the first three priorities have been completed, the PAG will consider other areas identified in the TOR, including: Group Audits, Reporting of KAMs and the use of Technology.
- 9 The scope of the PAG was expanded to also include consideration of any PS issues related to the implementation of the new suite of Quality Management Standards in Australia,

following the AUASB's decision in March not to carry forward PS Australian amendments to application and explanatory material from ASQC 1 to the new ASQM 1.

- 10 The PAG agreed that the key outcomes from work undertaken by the PAG in 2019 continue to be appropriate going forward. It was agreed that the ATG proceed in developing GS-text to address PS challenges related to ASA 210 *Agreeing the Terms of Audit Engagements*, based on deliberations from the October 2019 PAG meeting.
- 11 The Group briefly revisited the decision in 2019 to develop a Guidance Statement (GS) rather than opting for a standard-setting solution. The PAG agreed that a GS would be the best approach as GSs will have the necessary authority, can be issued quicker and tailored to be fit for purpose to address the specific needs of the PS.
- 12 The PAG agreed on the principle to develop and issue guidance in such a fashion that each topic is added incrementally to a framework, as opposed to a "single issue" GS that covers all issues. The PAG felt that the development of separate GSs to deal with individual topics will make it possible to yield results in the short term. This approach will also provide greater flexibility, as it will enable the ATG to produce a finished product in the short term for PAG and AUASB consideration and approval that can then be used as a template for the remaining topics.
- 13 The PAG also supported a proposal to develop some sort of overarching framework document to which topic specific guidance could be added.
- 14 The Group considered the option to:
  - develop and issue separate GSs for each topic as part of a series of PS GSs (the framework document will be the first GS in the series, similar to the AUASB Preamble); or, alternatively,
  - develop and incrementally add topic specific guidance to an umbrella framework (similar to building a book with different chapters).These options will be further explored at the next PAG meeting.
- 15 The ATG briefed the PAG on international developments in the PS audit space and provided background information on the proposed INTOSAI GUID 2900, which was issued by the Financial Audit and Accounting Subcommittee of INTOSAI (FAAS) for public comment in 2020. The PAG agreed that this guidance could potentially be useful as a resource to leverage off in developing Australian PS guidance.

## **Next steps/Way Forward**

- 16 The next PAG meeting will be held in the last week of June 2021. At this meeting the PAG will consider an outline of the overarching framework document that will accompany or sit over the series of topic specific PS GSs.