

May 2024

Explanatory Memorandum

Exposure Draft 01/24:

Proposed Revised Standard on Assurance Engagements ASAE 3500 Performance Engagements

Issued by the Auditing and Assurance Standards Board



Australian Government

Auditing and Assurance Standards Board

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Explanatory Memorandum
Exposure Draft 01/24: Proposed Revised Standard on Assurance Engagements
ASAE 3500 Performance Engagements

Important Note and Disclaimer

This Explanatory Memorandum is issued by the AUASB to provide information to assurance practitioners and other stakeholders about the AUASB's proposed narrow scope¹ amendments to Standard on Assurance Engagements ASAE 3500 *Performance Engagements*. The revised Standard would replace ASAE 3500 *Performance Engagements*, last revised and re-issued in October 2017. The extant Standard was updated in December 2022 to reflect consequential amendments to AUASB Standards arising from changes made by the IAASB to ISQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, ISQM 2 *Engagement Quality Reviews* and ISA 220 (Revised) *Quality Management for an Audit of Financial Statements*.

The Explanatory Memorandum, in itself, would 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 assurance practitioners are required to comply with when conducting a performance 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.

¹ The AUASB has adopted a simplified due process for addressing changes to existing standards that are considered to be narrow in scope — refer to paragraphs 176-197 of the AUASB [Due Process Framework for Developing, Issuing and Maintaining AUASB Pronouncements and Other Publications](#).

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EXPLANATORY MEMORANDUM

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Introduction

1. The AUASB has undertaken a narrow scope revision² of Standard on Assurance Engagements [ASAE 3500 Performance Engagements](#) (ASAE 3500) to address the key findings from the AUASB's Post Implementation Review of the Standard undertaken in 2023.
2. The AUASB, at its 23 May 2024 board meeting, approved *Exposure Draft 01/24: Proposed Revised Standard on Assurance Engagements ASAE 3500 Performance Engagements* (ED 01/24) for public exposure.
3. This Explanatory Memorandum (EM) accompanies, and should be read along with, ED 01/24. The aim of the EM is to provide stakeholders with background to, and an explanation of, ED 01/24; and to invite stakeholders to provide feedback on the AUASB's proposed revisions to ASAE 3500.

Request for Comments

4. The AUASB requests comments on all matters in relation to ED 01/24, but specifically in relation to the questions identified in the 'Exposure Draft Questions' section below.
 - The AUASB asks that comments are sufficiently detailed and include whether stakeholders agree or do not agree with the proposed amendments.
 - Stakeholders may address only specific questions relevant to them or raise matters not specifically addressed by a question.
 - The AUASB regards both supportive and critical comments as essential to a balanced review of the proposed revised Standard.
 - Comments will be most helpful when they refer to specific paragraphs, include the reasons for the comments and, when appropriate, make specific suggestions for any proposed changes to wording.

Comment Closing Date

5. Comments are invited on the Exposure Draft by no later than 30 July 2024.

² The AUASB has adopted a simplified due process for addressing changes to existing standards that are considered to be narrow in scope — refer to paragraphs 176-197 of the AUASB [Due Process Framework for Developing, Issuing and Maintaining AUASB Pronouncements and Other Publications](#).

Exposure Draft Questions

6. The AUASB is seeking comments from stakeholders on the questions below. In preparing your submission, please have regard to the guidelines set out in paragraph 4 of this EM.

1. Does the proposed revised Standard provide sufficient flexibility for it to be applied to a broad range of performance engagements in both the public sector and private sector? If not, what suggestions do you have for making this clearer?

[See ED 01/24, revised introductory paragraphs 3-10, revised definition of ‘performance engagement’ (paragraph 18(m)) and new definition of ‘performance principle’ (paragraphs 18(n) / A5)]. [EM paragraph 18(a)].

2. Does the proposed revised Standard provide appropriate principles for performing limited assurance performance engagements by appropriately addressing and differentiating the work effort between limited and reasonable assurance for relevant elements of the performance engagement? If not, what do you propose and why?

[See ED 01/24, paragraphs 4 / A2 and throughout]. [EM paragraphs 18(b), 18(c)(i)].

3. The proposed revised Standard uses the term ‘significance’ instead of the ASAE 3000³ term ‘materiality’ in the context of performance engagements.

[See ED 01/24, paragraphs 18(t), 31-33 / A31-A55]. [EM paragraph 18(c)(ii)].

- (a) Do you support the AUASB’s proposal to replace the extant concept of ‘materiality’ with the concept of ‘significance’ in the proposed revised Standard? If not, why not?
- (b) Do you agree with the new requirements and accompanying application material related to significance set out in paragraphs 31-33 / A31-A55 of ED 01/24 (which will replace extant paragraphs 29-31 / A26-A34)? If not, what do you propose and why?

4. Do you support the proposed revised requirements and accompanying application material in paragraphs 36-40 / A59-A82 of ED 01/24 (which will replace extant paragraphs 32-33 / A35-A39), which clarify:

- (a) the circumstances when internal controls could be considered relevant in the context of a performance engagement; and
- (b) the risk procedures the assurance practitioner is required to perform to obtain an understanding of internal controls relevant to the performance engagement.

If not, what do you propose and why?

[EM paragraph 18(c)(iii)]

³ ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.

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5. Is the proposed revised Standard sufficiently clear about the nature and extent of non-compliance with laws and regulations procedures the assurance practitioner is required to perform?

[See ED 01/24, paragraphs 35(a) / A58, which will replace extant paragraph 34].
[EM paragraph 18(c)(iv)]
6. Will the proposed revised reporting requirements and accompanying application material in paragraphs 52-59 / A101-A121 of ED 01/24 (which will replace extant paragraphs 43-48 / A49-A55) drive assurance reporting that meets the information needs of the intended users of assurance reports on an activity's performance? If not, please be specific about any matters that should not be required to be included in the assurance report, or any additional matters that should be included, and explain why.

[EM paragraph 18(d)]
7. Do you foresee any difficulties in implementing any of the new/revised requirements?
8. Have applicable laws and regulations been appropriately addressed in the proposed narrow scope amendments to the Standard?
9. Are there any laws or regulations that may, or do, prevent or impede the application of the proposed narrow scope amendments, or may conflict with the proposed narrow scope amendments to the Standard?
10. Are there any principles and practices considered appropriate in maintaining or improving assurance quality in Australia that may, or do, prevent or impede the application of, or may conflict with, the proposed narrow scope amendments to the Standard?
11. 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 those costs are likely to occur;
 - (b) The estimated extent of costs, in percentage terms (relative to audit fees); and
 - (c) Whether expected costs outweigh the benefits to the users of performance engagements?
12. Are there any other significant public interest matters that stakeholders wish to raise in relation to ED 01/24?

Background

ASAE 3500 Performance Engagements

7. ASAE 3500 deals with direct engagements in which an assurance practitioner (accountant or non-accountant) evaluates a responsible party or parties' performance of an activity against identified criteria and aims to obtain sufficient appropriate evidence to express, in a written direct assurance report, a conclusion to intended users about the outcome of that evaluation.
8. ASAE 3500 is an Australian Standard with no IAASB equivalent. It is issued by the AUASB under the AUASB's *Framework for Assurance Engagements*, which is consistent with the IAASB's equivalent Framework.
9. ASAE 3500 is used primarily by State, Territory or Commonwealth Auditors-General for conducting performance engagements in the public sector; however, may also be used in the private sector.
10. ASAE 3500 is to be applied in conjunction with ASAE 3000⁴. ASAE 3500 adapts the requirements in ASAE 3000, which is written primarily for attestation engagements (i.e. where management measures or evaluates the subject matter against criteria), as necessary, to direct engagements (i.e. where the assurance provider evaluates the subject matter against applicable criteria) on performance and identifies the requirements of ASAE 3000 which the assurance practitioner is required to comply with in addition to the requirements of ASAE 3500.

Post Implementation Review (PIR) of ASAE 3500

11. Extant ASAE 3500 was revised and reissued by the AUASB in October 2017.⁵ As required under the AUASB's Due Process Framework⁶, a [Post Implementation Review](#) (PIR) of the Standard was conducted during the period April-June 2023, to evaluate the effectiveness and efficiency of the revised Standard's implementation and application in practice.
12. For a summary of the key findings from the PIR, refer to the AUASB's [Feedback Statement](#) that has been released publicly on the AUASB website.

Narrow Scope Revision of ASAE 3500

13. At its June 2023 meeting, the AUASB supported the commencement of a new project to make narrow scope amendments to ASAE 3500, to address the key findings from the PIR.
14. The revision is considered narrow in scope as it was targeted at the specific issues identified by stakeholders that participated in the PIR, rather than undertaking a full-scale revision of the Standard in its entirety. The [Project Plan](#) provides further information on the objective and scope of the project, planned approach and consultation with stakeholders.
15. A Project Advisory Group (PAG), consisting of 9 members representing each Auditor-General's Office in Australia, was formed in July 2023 to assist the Office of the

⁴ ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

⁵ ASAE 3500 was updated in December 2022 to reflect conforming and consequential amendments in response to the revised suite of Quality Management Standards that became effective for financial reporting periods commencing on or after 15 December 2022.

⁶ [Due Process Framework for Developing, Issuing and Maintaining AUASB Pronouncements and Other Publications](#) — refer to paragraphs 250-254.

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AUASB with the revision. The PAG is chaired by the AUASB Deputy Chair, who is also the current Northern Territory Auditor-General.

16. The PAG met in August 2023 to discuss an Issues Paper prepared by the Office of the AUASB, which outlined the proposed narrow scope revisions to the Standard and identified specific matters where the PAG's input would be required. The PAG met on two further occasions in September 2023 and March 2024 to consider and provide feedback on aspects/drafts of the proposed revised Standard. PAG members also provided input to the development of the revised Standard in response to specific Requests for Information from the Office of the AUASB.
17. A final draft of ED 01/24 was shared with the PAG on 8 April 2024 for a fatal flaw review. All PAG members supported the amendments in the final draft and did not raise any fatal flaw issues.

Key Proposals

[Also refer to Appendix 1 — Summary of Key Changes to Extant ASAE 3500 (revised October 2017, updated December 2022)]

18. The changes proposed in ED 01/24 to address the key findings from the PIR are:
 - (a) **Amend extant ASAE 3500 to make it sufficiently clear that the Standard can be applied to a broad range of performance engagements in both the public sector and private sector.**

The existing ASAE 3500 expresses 'performance' in terms of economy, efficiency, and effectiveness only (the '3Es'). However, PIR stakeholder feedback revealed that, in practice, 'ethics' is considered a fundamental and co-equal element of the proper use and management of public resources. It is therefore proposed that references to 'economy, efficiency and effectiveness' in the extant Standard be replaced with the term 'performance principle(s)', which is now defined in the revised Standard. The definition of performance principle clarifies that, although performance engagements generally focus on one or more of the principles of economy, efficiency, effectiveness, and/or ethics, performance engagements may also focus on other principles such as equity, probity and sustainability (amongst others). See ED 01/24, revised introductory paragraphs 3-10, revised definition of 'performance engagement' (paragraph 18(m)) and new definition for 'performance principle' (paragraphs 18(n) / A5).
 - (b) **Expand the scope of extant ASAE 3500 to include specific requirements and application material for limited assurance performance engagements.**

The existing ASAE 3500 deals with direct engagements to provide a reasonable assurance report on the performance of an activity. The extant Standard does not include any requirements or application material for undertaking limited assurance engagements but allows for the Standard to be applied (adapted and supplemented as necessary) to limited assurance engagements.⁷

Paragraph 4 of ED 01/24 explains that, unless otherwise stated, each requirement of the proposed revised Standard applies to both reasonable and limited assurance

⁷ See extant ASAE 3500, paragraph 3.

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engagements. Requirements and Application and Other Explanatory Material that apply only to limited assurance or reasonable assurance engagements have been presented with the letter ‘L’ (limited assurance) or ‘R’ (reasonable assurance) after the paragraph number. Although some procedures are required only for reasonable assurance engagements, they may nonetheless be appropriate in some limited assurance engagements.

- (c) **Provide more specificity than ASAE 3000 (which is written primarily to apply to attestation engagements) for performance engagements (which are direct engagements), including further application material to demonstrate key principles, in the following areas:**
- (i) **The difference in work effort between limited and reasonable assurance in the context of a performance engagement.**
 - (ii) **The concept of materiality in the context of a performance engagement and matters to consider in applying materiality in a performance engagement.**

It is proposed that the term ‘significance’ replaces the ASAE 3000 term ‘materiality’ in the context of performance engagements.

Feedback from the PAG suggests the concept of significance may be more:

- Useful in the context of a performance engagement, which is a direct engagement (see paragraph A1 of ED 01/24, which outlines the unique features that differentiates direct engagements from attestation engagements). Members of the PAG considered significance to be a broader concept than the ASAE 3000 concept of materiality (which may be more relevant in the context of an attestation engagement). Therefore, it can be applied more flexibly at different stages of the engagement, from selecting the performance engagement topics and activities to examine, all the way through to reporting findings, formulating the assurance conclusion(s), and developing recommendations (see paragraph 31 of ED 01/24). Some PAG members noted that attempting to apply the ASAE 3000 concept of materiality at a criteria and sub-criteria level can be frustrating and inefficient, and does not help Audit Offices in making sure they are spending the taxpayer’s money reporting to Parliament on important issues where they could help improve government services.
- Meaningful to the lay person reading the assurance report, especially when communicated in terms of the causes and consequences of findings.

It is worthwhile noting that the Canadian Auditing and Assurance Standards Board has replaced the term ‘materiality’ with ‘significance’ in their ASAE 3000 equivalent standard for direct engagements⁸, and in related guidance on conducting a performance audit in the public sector.⁹ The Office

⁸ See CSAE 3001 *Direct Engagements*. CSAE 3001 requirements and application material related to significance mostly mirrors the requirements and application material for materiality included in ISAE 3000/ASAE 3000.

⁹ See Assurance and Related Services Guideline AuG-50 *Conducting a Performance Audit in the Public Sector in accordance with CSAE 3001*.

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of the Auditor General of Canada has adopted the term significance for use in the context of performance engagements.

The revised Standard includes new requirements and accompanying application material related to consideration of significance in the context of a performance engagement — see paragraphs 18(t), 31-33/A31-A55 of ED 01/24¹⁰.

- (iii) **The nature and extent of the assurance practitioner’s understanding of relevant internal controls in the context of a performance engagement — see paragraphs 34-40/A56-A82 of ED 01/24.**¹¹
- (iv) **Non-compliance with laws and regulations procedures in the context of a performance engagement — see paragraphs 35(a)/A58 of ED 01/24.**¹²
- (d) **Revise the reporting requirements of the Standard (content and format of the assurance report) to be clearer, and to provide additional explanatory and application material to promote consistent application in practice.**
 - PIR stakeholder feedback indicated divergent practices in applying the Standard’s reporting requirements in the different jurisdictions in Australia. Current practice is for Auditors-General to report their conclusions together with other information such as findings (that highlight both positive and negative aspects of performance) and recommendations, in a long form-report. Auditors-General consider such practice is consistent with their purpose of improving public sector performance and supporting accountability and transparency in the Australian government sector through their independent reporting. It is considered assurance reports on performance should also provide new information, analysis or insights and, where appropriate, recommendations for improvement, that could benefit all government entities.
 - Extant ASAE 3500 reporting requirements are based on the reporting requirements of ASAE 3000, which have been written primarily to apply to attestation engagements. ASAE 3000 has not yet been updated to reflect the updated reporting requirements of the revised ASA 700¹³. It is noted that the revised ASA 700 reporting requirements have been used as guide for developing the elements of the assurance report on sustainability information under ED ISSA 5000¹⁴.
 - Given ASA 700 and ED ISSA 5000 reflect the latest thinking about the form and content of an assurance practitioner’s report, these pronouncements were used as starting point in updating the extant ASAE 3500 reporting requirements — adapted and supplemented as necessary to apply to direct engagements. In line with the expanded scope of the Standard, the revised ASAE 3500 also now include reporting requirements for limited assurance performance engagements. See paragraphs 52-59/A101-A121 of ED 01/24.¹⁵

¹⁰ To replace extant ASAE 3500, paragraphs 29-31 and A26-A34.

¹¹ To replace extant ASAE 3500, paragraph 32-33/A35-A39.

¹² To replace extant ASAE 3500, paragraph 34.

¹³ ASA 700 *Forming an Opinion and Reporting on a Financial Report*.

¹⁴ Exposure Draft of Proposed International Standard on Sustainability Assurance (ISSA) 5000 *General Requirements for Sustainability Assurance Engagements*.

¹⁵ To replace extant ASAE 3500, paragraphs 43-48/A49-A55.

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(e) Other revisions:

- Replace extant ASAE 3500 Appendices 1-3 with revised (enhanced) Appendices 1 and 2 and new Appendix 3, to reflect revisions to the main body of the Standard.
- Make amendments to extant ASAE 3500 to make it easier to read and understand (a 'plain English' format) and to use terminology more familiar to performance assurance practitioners, who may not come from a traditional accounting or financial auditing background. The revised Standard will now also align closer to international standards and guidance on performance engagements issued by the International Organization of Supreme Audit Institutions (INTOSAI).

19. To track all changes made to the extant ASAE 3500, refer to Agenda Item 6.3 of the [May 2024 AUASB meeting papers](#) for the marked-up version of ED 01/24.

Proposed Application Date

20. It is proposed that the revised ASAE 3500 will be operative for assurance engagements commencing on or after 1 October 2024.

* * *

Appendix 1

Summary of Key Changes to Extant ASAE 3500 (revised October 2017, updated December 2022)

EM ¹⁶ Para. Ref.	Extant Para. Ref.	ED 01/24 Para. Ref.	How affected
18(a)	3-8 16(n) 16(o)	3-10 18(m) 18(n) /A5	Extant ASAE 3500 amended to make it sufficiently clear that the Standard can be applied to a broad range of performance engagements in both the public sector and private sector — <ul style="list-style-type: none"> Amended introduction section. Updated/new definitions. Additional application and other explanatory material.
18(b) 18(c)(i)	3 / A1	4 / A2 Throughout	Scope of extant ASAE 3500 expanded to include specific requirements and application material for limited assurance performance engagements — <ul style="list-style-type: none"> New requirements. New application and other explanatory material.
18(c)(ii)	16(m) 29-31 / A26-A34	18(t) 31-33 / A31-A55	The revised ASAE 3500 uses the term/concept ‘significance’ in the context of performance engagements, instead of the ASAE 3000 term/concept of ‘materiality’ — <ul style="list-style-type: none"> New definition. New requirements. New application and other explanatory material.
18(c)(iii)	32-33 / A35-A39	34-40 / A56-A82 18(j)(s)	The revised ASAE 3500 provides more specificity than ASAE 3000 re understanding of relevant internal controls in the context of performance engagements — <ul style="list-style-type: none"> Amended/new requirements. Amended/new application and other explanatory material. New definitions to differentiate between ‘risk procedures’ (18(s)) and ‘further procedures’ (18(j)).
18(c)(iv)	34	35(a) / A58	The revised ASAE 3500 provides more specificity than ASAE 3000 re non-compliance with laws and regulations procedures in the context of a performance engagement — <ul style="list-style-type: none"> Amended requirement. New application and other explanatory material.

¹⁶ Explanatory Memorandum to ED 01/24.

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18(d)	43-48 / A49-A55	52-59 / A101-A121	Extant ASAE 3500 reporting requirements (content and format of the assurance report) have been revised to be clearer — <ul style="list-style-type: none">• New/amended requirements (including for limited assurance engagements).• New/amended application and other explanatory material to promote consistent application in practice.
18(e)	Appendices 1-3	Appendices 1-3	Extant ASAE 3500 Appendices 1-3 replaced with revised (enhanced) Appendices 1 and 2 and new Appendix 3.
18(e)	Throughout	Throughout	Amendments throughout to make the Standard easier to read and understand and to align the Standard closer to international standards and guidance on performance engagements issued by INTOSAI ¹⁷ .

¹⁷ International Organization of Supreme Audit Institutions.