

EXPOSURE DRAFT

ED 2/08
(April 2008)

Proposed Auditing Standard
ASA 315
Identifying and Assessing the
Risks of Material
Misstatement Through
Understanding the Entity and
Its Environment (Revised and
Redrafted)
(Re-issuance of ASA 315)

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

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Australian Government

Auditing and Assurance Standards Board

Commenting on this Exposure Draft

Comments on this Exposure Draft should be forwarded so as to arrive by no later than 31 May 2008. Comments should be addressed to:

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AUDITING STANDARD ASA [315315315](#)

Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment (Revised and Redrafted)

The Application of this Standard

- Aus 0.1 This Auditing Standard applies to:
- (a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with Part 2M.3 of the *Corporations Act 2001*; and
 - (b) an audit of a financial report for any other purpose.
- Aus 0.2 This Auditing Standard also applies, as appropriate, to an audit of other financial information.

Operative Date

- Aus 0.3 This Auditing Standard is operative for financial reporting periods commencing on or after 1 January 2010.

Introduction

Scope of this ASA

1. This International Standard on Auditing (~~ISA~~[ISA](#)) deals with the auditor's responsibility to identify and assess the risks of material misstatement in the ~~financial statements~~[financial report](#), through understanding the entity and its environment, including the entity's internal control.

Effective Date

2. [deleted by AUASB. Refer Aus 0.3]

Objectives

3. The objectives of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and

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- (e) Significant risk – An identified and assessed risk of material misstatement that, in the auditor’s judgment, requires special audit consideration.

Requirements

Risk Assessment Procedures and Related Activities

- 5. The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Ref: Para. A1-A5)
- 7. The risk assessment procedures shall include the following:
 - (a) Inquiries of management, and of others within the entity who in the auditor’s judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. (Ref: Para. A6)
 - (b) Analytical procedures. (Ref: Para. A7-A8)
 - (c) Observation and inspection. (Ref: Para. A9)
- 8. The auditor shall consider whether information obtained from the auditor’s client acceptance or continuance process is relevant to identifying risks of material misstatement.
- 9. Where the engagement partner has performed other engagements for the entity, the engagement partner shall consider whether information obtained is relevant to identifying risks of material misstatement.

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- (a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical ~~behavior~~behaviour; and
 - (b) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control, and whether those other components are not undermined by control environment weaknesses. (Ref: Para. A65-A74)

The entity's risk assessment process

- 16. The auditor shall obtain an understanding of whether the entity has a process for:
 - (a) Identifying business risks relevant to financial reporting objectives;
 - (b) Estimating the significance of the risks;
 - (c) Assessing the likelihood of their occurrence; and
 - (d) Deciding about actions to address those risks. (Ref: Para. A75)
- 17. If the entity has established such a process (referred to hereafter as the 'entity's risk assessment process'), the auditor shall obtain an understanding of it, and the results thereof. Where the auditor identifies risks of material misstatement that management failed to identify, the auditor shall evaluate whether there was an underlying risk of a kind that the auditor expects would have been identified by the entity's risk assessment process. If there is such a risk, the auditor shall obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or if there is a material weakness in the entity's risk assessment process.
- 18. If the entity has not established such a process or has an ad hoc process, the auditor shall discuss with management whether business risks relevant to financial reporting objectives have been identified and how they have been addressed. The auditor shall evaluate

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whether the absence of a documented risk assessment process is appropriate in the circumstances, or represents a material weakness in the entity's internal control. (Ref: Para. A76)

The information system, including the related business processes, relevant to financial reporting, and communication

19. The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas:
- (a) The classes of transactions in the entity's operations that are significant to the ~~financial statements~~financial report;
 - (b) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the ~~financial statements~~financial report;
 - (c) The related accounting records, supporting information and specific accounts in the ~~financial statements~~financial report that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;
 - (d) How the information system captures events and conditions, other than transactions, that are significant to the ~~financial statements~~financial report;
 - (e) The financial reporting process used to prepare the entity's ~~financial statements~~financial report, including significant accounting estimates and disclosures; and
 - (f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments. (Ref: Para. A77-A81)

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25. The auditor shall identify and assess the risks of material misstatement at:
- (a) The financial statement level; and (Ref: Para. A98-A101)
 - (b) The assertion level for classes of transactions, account balances, and disclosures, (Ref: Para. A102-A106)

to provide a basis for designing and performing further audit procedures.

26. For this purpose, the auditor shall:
- (a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the ~~financial statements~~financial report; Ref: Para. A107-A108)
 - (b) Assess the identified risks, and evaluate whether they relate more pervasively to the ~~financial statements~~financial report as a whole and potentially affect many assertions;
 - (c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: Para. A109-A111)
 - (d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Risks that Require Special Audit Consideration

27. As part of the risk assessment as described in paragraph 24, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

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28. In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:
- (a) Whether the risk is a risk of fraud;
 - (b) Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;
 - (c) The complexity of transactions;
 - (d) Whether the risk involves significant transactions with related parties;
 - (e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
 - (f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual. (Ref: Para. A112-A116)
29. When the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk. (Ref: Para. A117-A119)

Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence

30. In respect of some risks, the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. In such cases, the entity's controls over such risks are relevant to the audit and the auditor shall obtain an understanding of them. (Ref: Para. A120-A122)

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Revision of Risk Assessment

31. The auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment, the auditor shall revise the assessment and modify the further planned audit procedures accordingly. (Ref: Para. A123)

Material Weakness in Internal Control

32. The auditor shall evaluate whether, on the basis of the audit work performed, the auditor has identified a material weakness in the design, implementation or maintenance of internal control. (Ref: Para. A124-A125)
33. The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility, and, as required by **ISAASA** 260 (Revised), "Communication with Those Charged with Governance,"¹ with those charged with governance (unless all of those charged with governance are involved in managing the entity). (Ref: Para. A126)

Documentation

34. The auditor shall document:
- (a) The discussion among the engagement team where required by paragraph 10, and the significant decisions reached;
 - (b) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph 11 and of each of the internal control

¹ Close off document approved May 2006.

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components specified in paragraphs 14-23; the sources of information from which the understanding was obtained; and the risk assessment procedures performed;

- (c) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level as required by paragraph 24; and
- (d) The risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements in paragraphs 26-29. (Ref: Para. A127-A130)

* * *

Application and Other Explanatory Material

Risk Assessment Procedures and Related Activities (Ref: Para. 5)

A1. Obtaining an understanding of the entity and its environment, including the entity’s internal control (referred to hereafter as an “understanding of the entity”), is a continuous, dynamic process of gathering, updating and ~~analyzing~~analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:

- ~~1~~1 Assessing risks of material misstatement of the ~~financial statements~~financial report;
- ~~2~~2 Establishing materiality and evaluating whether the judgment about materiality remains appropriate as the audit progresses;
- ~~3~~3 Considering the appropriateness of the selection and application of accounting policies, and the adequacy of financial statement disclosures;

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- 4. Identifying areas where special audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions;
 - 5. Developing expectations for use when performing analytical procedures;
 - 6. Responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence; and
 - 7. Evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and of management's oral and written representations.
- A2. Information obtained by performing risk assessment procedures and related activities may be used by the auditor as audit evidence to support assessments of the risks of material misstatement. In addition, the auditor may obtain audit evidence about classes of transactions, account balances, or disclosures and related assertions and about the operating effectiveness of controls, even though such procedures were not specifically planned as substantive procedures or as tests of controls. The auditor also may choose to perform substantive procedures or tests of controls concurrently with risk assessment procedures because it is efficient to do so.
- A3. The auditor uses professional judgment to determine the extent of the understanding required. The auditor's primary consideration is whether the understanding that has been obtained is sufficient to meet the objective stated in this ~~ISA~~ASA. The depth of the overall understanding that is required by the auditor is less than that possessed by management in managing the entity.
- A4. The risks to be assessed include both those due to error and those due to fraud, and both are covered by this ~~ISA~~ASA. However, the

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significance of fraud is such that further requirements and guidance are included in ~~ISA~~ASA 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of ~~Financial Statements~~Financial report,” in relation to risk assessment procedures and related activities to obtain information that is used to identify the risks of material misstatement due to fraud.

- A5. Although the auditor is required to perform all the risk assessment procedures described in paragraph 6 in the course of obtaining the required understanding of the entity (see paragraphs 11-23), the auditor is not required to perform all of them for each aspect of that understanding. Other procedures may be performed where the information to be obtained therefrom may be helpful in identifying risks of material misstatement. Examples of such procedures include:
- ➔ Reviewing information obtained from external sources such as trade and economic journals; reports by analysts, banks, or rating agencies; or regulatory or financial publications.
 - ➔ Making inquiries of the entity’s external legal counsel or of valuation experts that the entity has used.

Inquiries of Management and Others Within the Entity (Ref: Para. 6(a))

- A6. Much of the information obtained by the auditor’s inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority. For example:
- Inquiries directed towards those charged with governance may help the auditor understand the environment in which the ~~financial statements~~financial report are prepared.
 - Inquiries directed toward internal audit personnel may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity’s internal control and whether

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management has satisfactorily responded to findings from those procedures.

- Inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
- Inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contract terms.
- Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.

Analytical Procedures (Ref: Para. 6(b))

- A7. Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.
- A8. However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures. ~~ISA~~ASA 520, "Analytical Procedures," establishes

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requirements and provides guidance on the use of analytical procedures.

Observation and Inspection (Ref: Para. 6(c))

A9. Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment. Examples of such audit procedures include observation or inspection of the following:

- The entity's operations.
- Documents (such as business plans and strategies), records, and internal control manuals.
- Reports prepared by management (such as quarterly management reports and interim ~~financial statements~~ **financial report**) and those charged with governance (such as minutes of board of directors' meetings).
- The entity's premises and plant facilities.

Aus A9.1 **Tracing transactions through the information system relevant to financial reporting (walk-throughs).**

Information Obtained in Prior Periods (Ref: Para. 9)

A10. The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about such matters as:

~~(tt)~~• Past misstatements and whether they were corrected on a timely basis.

~~(tw)~~• The nature of the entity and its environment, and the entity's internal control.

~~(tc)~~• Significant changes that the entity or its operations may have undergone since the prior financial period, which may assist the auditor in gaining a sufficient understanding of

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the entity to identify and assess risks of material misstatement.

- A11. The auditor is required to determine whether information obtained in prior periods remains relevant, if the auditor intends to use that information for the purposes of the current audit. This is because changes in the control environment, for example, may affect the relevance of information obtained in the prior year. To determine whether changes have occurred that may affect the relevance of such information, the auditor may make inquiries and perform other appropriate audit procedures, such as walk-throughs of relevant systems.

Discussion Among the Engagement Team (Ref: Para. 10)

- A12. The discussion among the engagement team about the susceptibility of the entity's ~~financial statements~~financial report to material misstatement:

- Provides an opportunity for more experienced engagement team members, including the engagement partner, to share their insights based on their knowledge of the entity.
- Allows the engagement team members to exchange information about the business risks to which the entity is subject and about how and where the ~~financial statements~~financial report might be susceptible to material misstatement due to fraud or error.
- Assists the engagement team members to gain a better understanding of the potential for material misstatement of the ~~financial statements~~financial report in the specific areas assigned to them, and to understand how the results of the audit procedures that they perform may affect other aspects of the audit including the decisions about the nature, timing, and extent of further audit procedures.
- Provides a basis upon which engagement team members communicate and share new information obtained throughout the audit that may affect the assessment of risks

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- of material misstatement or the audit procedures performed to address these risks.
ISAASA 240 provides further requirements and guidance in relation to the discussion among the engagement team about the risks of fraud.

A13. It is not always necessary or practical for the discussion to include all members in a single discussion (as, for example, in a multi-location audit), nor is it necessary for all of the members of the engagement team to be informed of all of the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team including, if considered appropriate, specialists and those responsible for the audits of components, while delegating discussion with others, taking account of the extent of communication considered necessary throughout the engagement team. A communications plan, agreed by the engagement partner, may be useful.

Considerations Specific to Smaller Entities

A14. Many small audits are carried out entirely by the engagement partner (who may be a sole practitioner). In such situations, it is the engagement partner who, having personally conducted the planning of the audit, would be responsible for considering the susceptibility of the entity's ~~financial statements~~ **financial report** to material misstatement due to fraud or error.

The Required Understanding of the Entity and Its Environment, Including the Entity's Internal Control

The Entity and Its Environment

Industry, Regulatory and Other External Factors (Ref: Para. 11(a))

Industry Factors

A15. Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and

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technological developments. Examples of matters the auditor may consider include:

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

A16. The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of regulation. For example, long-term contracts may involve significant estimates of revenues and expenses that give rise to risks of material misstatement. In such cases, it is important that the engagement team include members with sufficient relevant knowledge and experience, as required by [ISA/ASA 220](#), "Quality Control for Audits of Historical Financial Information."

Regulatory Factors

A17. Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment. Examples of matters the auditor may consider include:

- Accounting principles and industry specific practices.
- Regulatory framework for a regulated industry.
- Legislation and regulation that significantly affect the entity's operations, including direct supervisory activities.
- Taxation (corporate and other).
- Government policies currently affecting the conduct of the entity's business, such as monetary, including foreign exchange controls, fiscal, financial incentives (for example,

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government aid programs), and tariffs or trade restrictions policies.

- Environmental requirements affecting the industry and the entity's business.

A18. ~~ISA~~ASA 250, "Consideration of Laws and Regulations in an Audit of ~~Financial Statements~~Financial report," includes some specific requirements related to the legal and regulatory framework applicable to the entity and the industry.

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Considerations specific to public sector entities

- A19. For the audits of public sector entities, in addition to legislation or regulations, there may be ministerial directives, government policy requirements and resolutions of the legislature that affect the entity's operations. Such elements are essential to consider when obtaining an understanding of the entity and its environment.

Other External Factors

- A20. Examples of other external factors affecting the entity that the auditor may consider include the general economic conditions, interest rates and availability of financing, and inflation or currency revaluation.

Nature of the Entity (Ref: Para.11(b))

- A21. An understanding of the nature of an entity enables the auditor to understand such matters as:

→• Whether the entity has a complex structure, for example with subsidiaries or other components in multiple locations. Complex structures often introduce issues that may give rise to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or special-purpose entities are accounted for appropriately.

→• The ownership, and relations between owners and other people or entities. This understanding assists in determining whether related party transactions have been identified and accounted for appropriately. ~~ISA~~ASA 550, "Related Parties," establishes requirements and provides guidance on the auditor's considerations relevant to related parties.

- A22. Examples of matters that the auditor may consider when obtaining an understanding of the nature of the entity include:

- *Business operations* – such as:

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- Nature of revenue sources, products or services, and markets, including involvement in electronic commerce such as Internet sales and marketing activities.
- Conduct of operations (for example, stages and methods of production, or activities exposed to environmental risks).
- Alliances, joint ventures, and outsourcing activities.
- Geographic dispersion and industry segmentation.
- Location of production facilities, warehouses, and offices, and location and quantities of inventories.
- Key customers and important suppliers of goods and services, employment arrangements (including the existence of union contracts, pension and other post employment benefits, stock option or incentive bonus arrangements, and government regulation related to employment matters).
- Research and development activities and expenditures.
- Transactions with related parties.
- *Investments and investment activities* – such as:
 - Planned or recently executed acquisitions or divestitures.
 - Investments and dispositions of securities and loans.
 - Capital investment activities.
 - Investments in non-consolidated entities, including partnerships, joint ventures and special-purpose entities.
- *Financing and financing activities* – such as:
 - Major subsidiaries and associated entities, including consolidated and non-consolidated structures.

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- A25. The entity conducts its business in the context of industry, regulatory and other internal and external factors. To respond to these factors, the entity's management or those charged with governance define objectives, which are the overall plans for the entity. Strategies are the approaches by which management intends to achieve its objectives. The entity's objectives and strategies may change over time.
- A26. Business risk is broader than the risk of material misstatement of the ~~financial statements~~ **financial report**, though it includes the latter. Business risk may arise from change or complexity. A failure to recognize the need for change may also give rise to business risk. Business risk may arise, for example, from:
- The development of new products or services that may fail;
 - A market which, even if successfully developed, is inadequate to support a product or service; or
 - Flaws in a product or service that may result in liabilities and reputational risk.
- A27. An understanding of the business risks facing the entity increases the likelihood of identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the ~~financial statements~~ **financial report**. However, the auditor does not have a responsibility to identify or assess all business risks because not all business risks give rise to risks of material misstatement.
- A28. Examples of matters that the auditor may consider when obtaining an understanding of the entity's objectives, strategies and related business risks that may result in a risk of material misstatement of the ~~financial statements~~ **financial report** include:
- Industry developments (a potential related business risk might be, for example, that the entity does not have the personnel or expertise to deal with the changes in the industry).

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- New products and services (a potential related business risk might be, for example, that there is increased product liability).
- Expansion of the business (a potential related business risk might be, for example, that the demand has not been accurately estimated).
- New accounting requirements (a potential related business risk might be, for example, incomplete or improper implementation, or increased costs).
- Regulatory requirements (a potential related business risk might be, for example, that there is increased legal exposure).
- Current and prospective financing requirements (a potential related business risk might be, for example, the loss of financing due to the entity's inability to meet requirements).
- Use of IT (a potential related business risk might be, for example, that systems and processes are incompatible).
- The effects of implementing a strategy, particularly any effects that will lead to new accounting requirements (a potential related business risk might be, for example, incomplete or improper implementation).

A29. A business risk may have an immediate consequence for the risk of material misstatement for classes of transactions, account balances, and disclosures at the assertion level or the financial statement level. For example, the business risk arising from a contracting customer base may increase the risk of material misstatement associated with the valuation of receivables. However, the same risk, particularly in combination with a contracting economy, may also have a longer-term consequence, which the auditor considers when assessing the appropriateness of the going concern assumption. Whether a business risk may result in a risk of material misstatement is, therefore, considered in light of the entity's circumstances.

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Examples of conditions and events that may indicate risks of material misstatement are indicated in Appendix 2.

- A30. Usually, management identifies business risks and develops approaches to address them. Such a risk assessment process is part of internal control and is discussed in paragraph 15 and paragraphs A75-A76.

Considerations Specific to Public Sector Entities

- A31. For the audits of public sector entities, “management objectives” may be influenced by concerns regarding public accountability and may include objectives which have their source in legislation, regulations, government ordinances, and ministerial directives.

Measurement and Review of the Entity’s Financial Performance (Ref: Para.11(e))

- A32. Management and others will measure and review those things they regard as important. Performance measures, whether external or internal, create pressures on the entity. These pressures, in turn, may motivate management to take action to improve the business performance or to misstate the ~~financial statements~~ **financial report**. Accordingly, an understanding of the entity’s performance measures assists the auditor in considering whether pressures to achieve performance targets may result in management actions that increase the risks of material misstatement, including those due to fraud – See **ISAASA** 240 for requirements and guidance in relation to the risks of fraud.

- A33. The measurement and review of financial performance is not the same as the monitoring of controls (discussed as a component of internal control in paragraphs A94-A97), though their purposes may overlap:

- The measurement and review of performance is directed at whether business performance is meeting the objectives set by management (or third parties).

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may indicate the potential risk of management bias in the preparation of the ~~financial statements~~ **financial report**.

Considerations Specific to Smaller Entities

- A37. Smaller entities often do not have processes to measure and review financial performance. Inquiry of management may reveal that it relies on certain key indicators for evaluating financial performance and taking appropriate action. If such inquiry indicates an absence of performance measurement or review, there may be an increased risk of misstatements not being detected and corrected.

The Entity's Internal Control

- A38. An understanding of internal control assists the auditor in identifying types of potential misstatements and factors that affect the risks of material misstatement, and in designing the nature, timing, and extent of further audit procedures.
- A39. The following application material on internal control is presented in four sections, as follows:
- General Nature and Characteristics of Internal Control.
 - Controls Relevant to the Audit.
 - Nature and Extent of the Understanding of Relevant Controls.
 - Components of Internal Control.

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General Nature and Characteristics of Internal Control (Ref: Para. 12)

Purpose of Internal Control

A40. Internal control is designed, implemented and maintained to address identified business risks that threaten the achievement of any of the entity's objectives that concern:

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

The way in which internal control is designed, implemented and maintained varies with an entity's size and complexity.

Considerations specific to smaller entities

A41. Smaller entities may use less structured means and simpler processes and procedures to achieve their objectives.

Limitations of Internal Control

A42. Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives of preparing a financial report for external purposes that gives a true and fair view (or is presented fairly, in all material respects) in accordance with applicable financial reporting framework. The likelihood of their achievement is affected by limitations inherent to internal control. These include the realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error. For example, there may be an error in the design of, or in the change to, a control. Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.

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A43. Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or ~~disa~~isabled.

A44. Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.

Considerations specific to smaller entities

A45. Smaller entities often have fewer employees which may limit the extent to which segregation of duties is practicable. However, in a small owner-managed entity, the owner-manager² may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.

A46. On the other hand, the owner-manager may be more able to override controls because the system of internal control is less structured. This is taken into account by the auditor when identifying the risks of material misstatement due to fraud.

Division of Internal Control into Components

A47. The division of internal control into the following five components, for purposes of the ~~ISA~~ASAs, provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit:

- (a) The control environment;

² Owner-manager refers to the proprietor of an entity who is involved in running the entity on a day-to-day basis.

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- (b) The entity's risk assessment process;
 - (c) The information system, including the related business processes, relevant to financial reporting, and communication;
 - (d) Control activities; and
 - (e) Monitoring of controls.

The division does not necessarily reflect how an entity designs, implements and maintains internal control, or how it may classify any particular component. Auditors may use different terminology or frameworks to describe the various aspects of internal control, and their effect on the audit than those used in this ~~ISAASA~~, provided all the components described in this ~~ISAASA~~ are addressed.

A48. Application material relating to the five components of internal control as they relate to a financial statement audit is set out in paragraphs A65-A97 below. Appendix 1 provides further explanation of these components of internal control.

Characteristics of Manual and Automated Elements of Internal Control Relevant to the Auditor's Risk Assessment

A49. An entity's system of internal control contains manual elements and often contains automated elements. The characteristics of manual or automated elements are relevant to the auditor's risk assessment and further audit procedures based thereon.

A50. The use of manual or automated elements in internal control also affects the manner in which transactions are initiated, recorded, processed, and reported:

- Controls in a manual system may include such procedures as approvals and reviews of transactions, and reconciliations and follow-up of reconciling items. Alternatively, an entity may use automated procedures to

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initiate, record, process, and report transactions, in which case records in electronic format replace paper documents.

- Controls in IT systems consist of a combination of automated controls (for example, controls embedded in computer programs) and manual controls. Further, manual controls may be independent of IT, may use information produced by IT, or may be limited to monitoring the effective functioning of IT and of automated controls, and to handling exceptions. When IT is used to initiate, record, process or report transactions, or other financial data for inclusion in ~~the financial statements~~**financial report**, the systems and programs may include controls related to the corresponding assertions for material accounts or may be critical to the effective functioning of manual controls that depend on IT.

An entity's mix of manual and automated elements in internal control varies with the nature and complexity of the entity's use of IT.

A51. Generally, IT benefits an entity's internal control by enabling an entity to:

- Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;
- Enhance the timeliness, availability, and accuracy of information;
- Facilitate the additional analysis of information;
- Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;
- Reduce the risk that controls will be circumvented; and

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- Enhance the ability to achieve effective segregation of duties by implementing security controls in applications, databases, and operating systems.

A52. IT also poses specific risks to an entity's internal control, including, for example:

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

A53. Manual elements in internal control may be more suitable where judgment and discretion are required such as for the following circumstances:

- Large, unusual or non-recurring transactions.
- Circumstances where errors are difficult to define, anticipate or predict.

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- In changing circumstances that require a control response outside the scope of an existing automated control.
- In monitoring the effectiveness of automated controls.

A54. Manual elements in internal control may be less reliable than automated elements because they can be more easily bypassed, ignored, or overridden and they are also more prone to simple errors and mistakes. Consistency of application of a manual control element cannot therefore be assumed. Manual control elements may be less suitable for the following circumstances:

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

A55. The extent and nature of the risks to internal control vary depending on the nature and characteristics of the entity's information system. The entity responds to the risks arising from the use of IT or from use of manual elements in internal control by establishing effective controls in light of the characteristics of the entity's information system.

Controls Relevant to the Audit

A56. There is a direct relationship between an entity's objectives and the controls it implements to provide reasonable assurance about their achievement. The entity's objectives, and therefore controls, relate to financial reporting, operations and compliance; however, not all of these objectives and controls are relevant to the auditor's risk assessment.

A57. Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

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- Materiality.
- The significance of the related risk.
- The size of the entity.
- The nature of the entity's business, including its ~~organization~~organisation and ownership characteristics.
- The diversity and complexity of the entity's operations.
- Applicable legal and regulatory requirements.
- The circumstances and the applicable component of internal control.
- The nature and complexity of the systems that are part of the entity's internal control, including the use of service ~~organization~~organisations.
- Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

A58. Controls over the completeness and accuracy of information produced by the entity may be relevant to the audit if the auditor intends to make use of the information in designing and performing further procedures. Controls relating to operations and compliance objectives may also be relevant to an audit if they relate to data the auditor evaluates or uses in applying audit procedures.

A59. Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. The auditor's consideration of such controls is generally limited to those relevant to the reliability of financial reporting.

A60. An entity generally has controls relating to objectives that are not relevant to an audit and therefore need not be considered. For example, an entity may rely on a sophisticated system of automated

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- Tracing transactions through the information system relevant to financial reporting.

Inquiry alone, however, is not sufficient for such purposes.

- A64. Obtaining an understanding of an entity's controls is not sufficient to test their operating effectiveness, unless there is some automation that provides for the consistent operation of the controls. For example, obtaining audit evidence about the implementation of a manual control at a point in time does not provide audit evidence about the operating effectiveness of the control at other times during the period under audit. However, because of the inherent consistency of IT processing (see paragraph A51), performing audit procedures to determine whether an automated control has been implemented may serve as a test of that control's operating effectiveness, depending on the auditor's assessment and testing of controls such as those over program changes. Tests of the operating effectiveness of controls are further described in [ISA/ASA 330](#), "The Auditor's Responses to Assessed Risks."

Components of Internal Control—Control Environment (Ref: Para. 14)

- A65. 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 and its importance in the entity. The control environment sets the tone of an ~~organization~~organisation, influencing the control consciousness of its people.
- A66. Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:
- (a) *Communication and enforcement of integrity and ethical values* – These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.
 - (b) *Commitment to competence* – Matters such as management's consideration of the competence levels for

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particular jobs and how those levels translate into requisite skills and knowledge.

- (c) *Participation by those charged with governance* – Attributes of those charged with governance such as:
- Their independence from management.
 - Their experience and stature.
 - The extent of their involvement and the information they receive, and the scrutiny of activities.
 - The appropriateness of their actions, including the degree to which difficult questions are raised and pursued with management, and their interaction with internal and external auditors.
- (d) *Management's philosophy and operating style* – Characteristics such as management's:
- Approach to taking and managing business risks.
 - Attitudes and actions toward financial reporting.
 - Attitudes toward information processing and accounting functions and personnel.
- (e) ~~Organization~~*Organisation* ~~al~~ structure – The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.
- (f) *Assignment of authority and responsibility* - Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorization hierarchies are established.
- (g) *Human resource policies and practices* – Policies and practices that relate to, for example, recruitment,

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orientation, training, evaluation, ~~counseling~~counselling, promotion, compensation, and remedial actions.

Audit Evidence for Elements of the Control Environment

A67. Relevant audit evidence may be obtained through a combination of inquiries and other risk assessment procedures such as corroborating inquiries through observation or inspection of documents. For example, through inquiries of management and employees, the auditor may obtain an understanding of how management communicates to employees its views on business practices and ethical ~~behavior~~behaviour. The auditor may then determine whether relevant controls have been implemented by considering, for example, whether management has a written code of conduct and whether it acts in a manner that supports the code.

Effect of the Control Environment on the Assessment of the Risks of Material Misstatement

A68. Some elements of an entity's control environment have a pervasive effect on assessing the risks of material misstatement. For example, an entity's control consciousness is influenced significantly by those charged with governance, because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment in relation to participation by those charged with governance is therefore influenced by such matters as:

- Their independence from management and their ability to evaluate the actions of management.
- Whether they understand the entity's business transactions.

~~—Aus 68.1~~ The extent to which they evaluate whether the ~~financial statements~~financial report gives a true and fair view (or is presented fairly, in all material respects) ~~are prepared~~ in accordance with the applicable financial reporting framework.

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- A69. An active and independent board of directors may influence the philosophy and operating style of senior management. However, other elements may be more limited in their effect. For example, although human resource policies and practices directed toward hiring competent financial, accounting, and IT personnel may reduce the risk of errors in processing financial information, they may not mitigate a strong bias by top management to overstate earnings.
- A70. The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory control environment is not an absolute deterrent to fraud. Conversely, weaknesses in the control environment may undermine the effectiveness of controls, in particular in relation to fraud. For example, management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorized transactions to be processed. As explained in ISA/ASA 330, the control environment also influences the nature, timing, and extent of the auditor's further procedures.
- A71. The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement.

Considerations Specific to Smaller Entities

- A72. The control environment within small entities is likely to differ from larger entities. For example, those charged with governance in small entities may not include an independent or outside member, and the role of governance may be undertaken directly by the owner-manager where there are no other owners. The nature of the control environment may also influence the significance of other controls, or their absence. For example, the active involvement of an owner-manager may mitigate certain of the risks arising from a lack of

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segregation of duties in a small business; it may, however, increase other risks, for example, the risk of override of controls.

A73. In addition, audit evidence for elements of the control environment in smaller entities may not be available in documentary form, in particular where communication between management and other personnel may be informal, yet effective. For example, small entities might not have a written code of conduct but, instead, develop a culture that emphasizes the importance of integrity and ethical ~~behavior~~behaviour through oral communication and by management example.

A74. Consequently, the attitudes, awareness and actions of management or the owner-manager are of particular importance to the auditor's understanding of a smaller entity's control environment.

Components of Internal Control—The Entity's Risk Assessment Process (Ref: Para. 15)

A75. The entity's risk assessment process forms the basis for how management determines the risks to be managed. If that process is appropriate to the circumstances, including the nature, size and complexity of the entity, it assists the auditor in identifying risks of material misstatement. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment.

Considerations Specific to Smaller Entities (Ref: Para. 17)

A76. There is unlikely to be an established risk assessment process in a small entity. In such cases, it is likely that management will identify risks through direct personal involvement in the business. Irrespective of the circumstances, however, inquiry about identified risks and how they are addressed by management is still necessary.

Components of Internal Control—The Information System, Including the Related Business Processes, Relevant to Financial Reporting, and Communication

The Information System, Including Related Business Processes, Relevant to Financial Reporting (Ref: Para. 18)

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- A77. The information system relevant to financial reporting objectives, which includes the accounting system, consists of the procedures and records designed and established to:
- Initiate, record, process, and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities, and equity;
 - Resolve incorrect processing of transactions, for example, automated suspense files and procedures followed to clear suspense items out on a timely basis;
 - Process and account for system overrides or bypasses to controls;
 - Transfer information from transaction processing systems to the general ledger;
 - Capture information relevant to financial reporting for events and conditions other than transactions, such as the depreciation and amortization of assets and changes in the recoverability of accounts receivables; and
 - Ensure information required to be disclosed by the applicable financial reporting framework is accumulated, recorded, processed, summarized and appropriately reported in the ~~financial statements~~[financial report](#).

Journal entries

A78. An entity's information system typically includes the use of standard journal entries that are required on a recurring basis to record transactions. Examples might be journal entries to record sales, purchases, and cash disbursements in the general ledger, or to record accounting estimates that are periodically made by management, such as changes in the estimate of uncollectible accounts receivable.

A79. An entity's financial reporting process also includes the use of non-standard journal entries to record non-recurring, unusual transactions or adjustments. Examples of such entries include consolidating

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adjustments and entries for a business combination or disposal or non-recurring estimates such as the impairment of an asset. In manual general ledger systems, non-standard journal entries may be identified through inspection of ledgers, journals, and supporting documentation. When automated procedures are used to maintain the general ledger and prepare ~~financial statements~~ **financial report**, such entries may exist only in electronic form and may therefore be more easily identified through the use of computer-assisted audit techniques.

Related business processes

A80. An entity's business processes are the activities designed to:

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

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

Considerations specific to smaller entities

A81. Information systems and related business processes relevant to financial reporting in small entities are likely to be less sophisticated than in larger entities, but their role is just as significant. Small entities with active management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the entity's systems and processes may therefore be easier in an audit of smaller entities, and may be more dependent on inquiry than on review of

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documentation. The need to obtain an understanding, however, remains important.

Communication (Ref: Para. 19)

A82. Communication by the entity of the financial reporting roles and responsibilities and of significant matters relating to financial reporting involves providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting. It includes such matters as the extent to which personnel understand how their activities in the financial reporting information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity. Communication may take such forms as policy manuals and financial reporting manuals. Open communication channels help ensure that exceptions are reported and acted on.

Considerations specific to smaller entities

A83. Communication may be less structured and easier to achieve in a small entity than in a larger entity due to fewer levels of responsibility and management's greater visibility and availability.

Components of Internal Control—Control Activities (Ref: Para. 20)

A84. Control activities are the policies and procedures that help ensure that management directives are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various ~~organization~~organisational and functional levels. Examples of specific control activities include those relating to the following:

- Authorization.
- Performance reviews.
- Information processing.
- Physical controls.

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- Segregation of duties.

A85. Control activities that are relevant to the audit are:

- Those that are required to be treated as such, being control activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence, as required by paragraphs 28 and 29, respectively; or
- Those that are considered to be relevant in the judgment of the auditor.

A86. The auditor's judgment about whether a control activity is relevant to the audit is influenced by the risk that the auditor has identified that may give rise to a material misstatement and whether the auditor thinks it is likely to be appropriate to test the operating effectiveness of the control in determining the extent of substantive testing.

A87. The auditor's emphasis may be on identifying and obtaining an understanding of control activities that address the areas where the auditor considers that risks of material misstatement are likely to be higher. When multiple control activities each achieve the same objective, it is unnecessary to obtain an understanding of each of the control activities related to such objective.

A88. The auditor's knowledge about the presence or absence of control activities obtained from the understanding of the other components of internal control assists the auditor in determining whether it is necessary to devote additional attention to obtaining an understanding of control activities.

Considerations Specific to Smaller Entities

A89. The concepts underlying control activities in small entities are likely to be similar to those in larger entities, but the formality with which they operate may vary. Further, small entities may find that certain types of control activities are not relevant because of controls applied by management. For example, management's sole authority

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for granting credit to customers and approving significant purchases can provide strong control over important account balances and transactions, lessening or removing the need for more detailed control activities.

- A90. Control activities relevant to the audit of a smaller entity are likely to relate to the main transaction cycles such as revenues, purchases and employment expenses.

Risks Arising From IT (Ref: Para. 21)

- A91. The use of IT affects the way that control activities are implemented. From the auditor's perspective, controls over IT systems are effective when they maintain the integrity of information and the security of the data such systems process, and include effective general IT-controls and application controls.

- A92. General IT-controls are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environments. General IT-controls that maintain the integrity of information and security of data commonly include controls over the following:

- Data ~~center~~centre and network operations.
- System software acquisition, change and maintenance.
- Program change.
- Access security.
- Application system acquisition, development, and maintenance.

They are generally implemented to deal with the risks referred to in paragraph A52 above.

- A93. Application controls are manual or automated procedures that typically operate at a business process level and apply to the

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processing of individual applications. Application controls can be preventive or detective in nature and are designed to ensure the integrity of the accounting records. Accordingly, application controls relate to procedures used to initiate, record, process and report transactions or other financial data. These controls help ensure that transactions occurred, are authorized, and are completely and accurately recorded and processed. Examples include edit checks of input data, and numerical sequence checks with manual follow-up of exception reports or correction at the point of data entry.

Components of Internal Control—Monitoring of Controls (Ref: Para. 22)

- A94. Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis and taking necessary corrective actions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.
- A95. In many entities, internal auditors or personnel performing similar functions contribute to the monitoring of an entity's activities. [ISA/ASA](#) 610, "Considering the Work of Internal Audit" establishes requirements and provides guidance on the auditor's consideration of the work of internal auditing. Management's monitoring activities may also include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.

Considerations Specific to Smaller Entities

- A96. Management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to corrective action to the control.

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Sources of Information (Ref: Para. 23)

A97. Much of the information used in monitoring may be produced by the entity's information system. If management assumes that data used for monitoring are accurate without having a basis for that assumption, errors that may exist in the information could potentially lead management to incorrect conclusions from its monitoring activities. Accordingly, an understanding of:

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

is required as part of the auditor's understanding of the entity's monitoring activities as a component of internal control.

Identifying and Assessing the Risks of Material Misstatement

Assessment of Risks of Material Misstatement at the Financial Statement Level (Ref: Para. 24 (a))

A98. Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the ~~financial statements~~financial report as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level, for example, through management override of internal control. Financial statement level risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud.

A99. Risks at the financial statement level may derive in particular from a weak control environment (although these risks may also relate to other factors, such as declining economic conditions). For example, weaknesses such as management's lack of competence may have a

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more pervasive effect on the ~~financial statements~~financial report and may require an overall response by the auditor.

- A100. The auditor's understanding of internal control may raise doubts about the auditability of an entity's ~~financial statements~~financial report. For example:
- Concerns about the integrity of the entity's management may be so serious as to cause the auditor to conclude that the risk of management misrepresentation in the ~~financial statements~~financial report is such that an audit cannot be conducted.
 - Concerns about the condition and reliability of an entity's records may cause the auditor to conclude that it is unlikely that sufficient appropriate audit evidence will be available to support an unqualified opinion on the ~~financial statements~~financial report.
- A101. ~~ISA~~ASA 705, "Modifications to the Opinion in the Independent Auditor's Report" establishes requirements and provides guidance in determining whether there is a need for the auditor to consider a qualification or disclaimer of opinion or, as may be required in some cases, to withdraw from the engagement where this is legally possible.

Assessment of Risks of Material Misstatement at the Assertion Level (Ref: Para. 24(b))

- A102. Risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. In identifying and assessing risks of material misstatement at the assertion level, the auditor may conclude that the identified risks relate more pervasively to the ~~financial statements~~financial report as a whole and potentially affect many assertions.

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The Use of Assertions

- A103. In representing that the ~~financial statements~~ **financial report** are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation and disclosure of the various elements of ~~financial statements~~ **financial report** and related disclosures.
- A104. Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms:
- (a) Assertions about classes of transactions and events for the period under audit:
 - (i) Occurrence—transactions and events that have been recorded have occurred and pertain to the entity.
 - (ii) Completeness—all transactions and events that should have been recorded have been recorded.
 - (iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately.
 - (iv) Cutoff—transactions and events have been recorded in the correct accounting period.
 - (v) Classification—transactions and events have been recorded in the proper accounts.
 - (b) Assertions about account balances at the period end:
 - (i) Existence—assets, liabilities, and equity interests exist.

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- (ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
 - (iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded.
 - (iv) Valuation and allocation—assets, liabilities, and equity interests are included in the ~~financial statements~~ financial report at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.
- (c) Assertions about presentation and disclosure:
- (i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.
 - (ii) Completeness—all disclosures that should have been included in the ~~financial statements~~ financial report have been included.
 - (iii) Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.
 - (iv) Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.

A105. The auditor may use the assertions as described above or may express them differently provided all aspects described above have been covered. For example, the auditor may choose to combine the assertions about transactions and events with the assertions about account balances.

Considerations specific to public sector entities

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A106. When making assertions about the ~~financial statements~~financial report of public sector entities, in addition to those assertions set out in paragraph A104, management may often assert that transactions and events have been carried out in accordance with legislation or proper authority. Such assertions may fall within the scope of the financial statement audit.

Process of Identifying Risks of Material Misstatement (Ref: Para. 25(a))

A107. Information gathered by performing risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, is used as audit evidence to support the risk assessment. The risk assessment determines the nature, timing, and extent of further audit procedures to be performed.

A108. Appendix 2 provides examples of conditions and events that may indicate the existence of risks of material misstatement.

Relating Controls to Assertions (Ref: Para. 25(c))

A109. In making risk assessments, the auditor may identify the controls that are likely to prevent, or detect and correct, material misstatement in specific assertions. Generally, it is useful to obtain an understanding of controls and relate them to assertions in the context of processes and systems in which they exist because individual control activities often do not in themselves address a risk. Often, only multiple control activities, together with other components of internal control, will be sufficient to address a risk.

A110. Conversely, some control activities may have a specific effect on an individual assertion embodied in a particular class of transactions or account balance. For example, the control activities that an entity established to ensure that its personnel are properly counting and recording the annual physical inventory relate directly to the existence and completeness assertions for the inventory account balance.

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A111. Controls can be either directly or indirectly related to an assertion. The more indirect the relationship, the less effective that control may be in preventing, or detecting and correcting, misstatements in that assertion. For example, a sales manager's review of a summary of sales activity for specific stores by region ordinarily is only indirectly related to the completeness assertion for sales revenue. Accordingly, it may be less effective in reducing risk for that assertion than controls more directly related to that assertion, such as matching shipping documents with billing documents.

Significant Risks

Identifying Significant Risks (Ref: Para. 27)

A112. Significant risks often relate to significant non-routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty. Routine, non-complex transactions that are subject to systematic processing are less likely to give rise to significant risks.

A113. Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

- Greater management intervention to specify the accounting treatment.
- Greater manual intervention for data collection and processing.
- Complex calculations or accounting principles.
- The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

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A114. Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:

- Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
- Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

A115. ~~ISA~~ASA 330 describes the consequences for further audit procedures of identifying a risk as significant.

Significant risks relating to the risks of material misstatement due to fraud

A116. ~~ISA~~ASA 240 provides further requirements and guidance in relation to the identification and assessment of the risks of material misstatement due to fraud.

Understanding Controls Related to Significant Risks (Ref: Para. 28)

A117. Although risks relating to significant non-routine or judgmental matters are often less likely to be subject to routine controls, management may have other responses intended to deal with such risks. Accordingly, the auditor's understanding of whether the entity has designed and implemented controls for significant risks arising from non-routine or judgmental matters includes whether and how management responds to the risks. Such responses might include:

- Control activities such as a review of assumptions by senior management or experts.
- Documented processes for estimations.
- Approval by those charged with governance.

A118. For example, where there are one-off events such as the receipt of notice of a significant lawsuit, consideration of the entity's response

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may include such matters as whether it has been referred to appropriate experts (such as internal or external legal counsel), whether an assessment has been made of the potential effect, and how it is proposed that the circumstances are to be disclosed in the ~~financial statements~~financial report.

- A119. In some cases, management may not have appropriately responded to significant risks of material misstatement by implementing controls over these significant risks. This may indicate a material weakness in the entity's internal control.

Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence (Ref: Para. 29)

- A120. Risks of material misstatement may relate directly to the recording of routine classes of transactions or account balances, and the preparation of reliable ~~financial statements~~financial report. Such risks may include risks of inaccurate or incomplete processing for routine and significant classes of transactions such as an entity's revenue, purchases, and cash receipts or cash payments.

- A121. Where such routine business transactions are subject to highly automated processing with little or no manual intervention, it may not be possible to perform only substantive procedures in relation to the risk. For example, the auditor may consider this to be the case in circumstances where a significant amount of an entity's information is initiated, recorded, processed, or reported only in electronic form such as in an integrated system. 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.

- A122. The consequences for further audit procedures of identifying such risks are described in ~~ISA~~ASA 330.

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Revision of Risk Assessment (Ref: Para. 30)

A123. During the audit, information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example, the risk assessment may be based on an expectation that certain controls are operating effectively. In performing tests of those controls, the auditor may obtain audit evidence that they were not operating effectively at relevant times during the audit. Similarly, in performing substantive procedures the auditor may detect misstatements in amounts or frequency greater than is consistent with the auditor's risk assessments. In such circumstances, the risk assessment may not appropriately reflect the true circumstances of the entity and the further planned audit procedures may not be effective in detecting material misstatements. See [ISA/ASA 330](#) for further guidance.

Material Weakness in Internal Control (Ref: Para. 31)

A124. The types of material weaknesses in internal control that the auditor may identify when obtaining an understanding of the entity and its internal controls may include:

- Risks of material misstatement that the auditor identifies and which the entity has not controlled, or for which the relevant control is inadequate.
- A weakness in the entity's risk assessment process that the auditor identifies as material, or the absence of a risk assessment process in those cases where it would be appropriate for one to have been established.

A125. Material weaknesses may also be identified in controls that prevent, or detect and correct, error, or those to prevent and detect fraud.

Considerations Specific to Public Sector Entities (Ref: Para. 32)

A126. In the audit of public sector entities, there may be additional communication or reporting requirements for public sector auditors. For example, internal control weaknesses may have to be reported to the legislature or other governing body.

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Documentation (Ref: Para. 33)

- A127. The manner in which the requirements of paragraph 33 are documented is for the auditor to determine using professional judgment. For example, in audits of small entities the documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan that is required by ~~ISA~~ASA 300, "Planning an Audit of ~~Financial Statements~~Financial report." Similarly, for example, the results of the risk assessment may be documented separately, or may be documented as part of the auditor's documentation of further procedures (see ~~ISA~~ASA 330). The form and extent of the documentation is influenced by the nature, size and complexity of the entity and its internal control, availability of information from the entity and the audit methodology and technology used in the course of the audit.
- A128. For entities that have uncomplicated businesses and processes relevant to financial reporting, the documentation may be simple in form and relatively brief. It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it. Key elements of understanding documented by the auditor include those on which the auditor based the assessment of the risks of material misstatement.
- A129. The extent of documentation may also reflect the experience and capabilities of the members of the audit engagement team. Provided the requirements of ~~ISA~~ASA 230, "Audit Documentation," are always met, an audit undertaken by an engagement team comprising less experienced individuals may require more detailed documentation to assist them to obtain an appropriate understanding of the entity than one that includes experienced individuals.
- A130. For recurring audits, certain documentation may be carried forward, updated as necessary to reflect changes in the entity's business or processes.

Conformity with International Standards on Auditing

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A131. Except as noted below, this Auditing Standard conforms with International Standard on Auditing ~~ISA~~ISA 315, issued by the International Auditing and Assurance Standards Board, as an independent standard-setting body within the International Federation of Accountants. The main difference(s) between this Auditing Standard and ~~ISA~~ISA 315 ~~is~~(are):

- This Auditing Standard includes Application and other Explanatory Material on the following matter not contained in ISA 315 (Redrafted): ⇄
 - Guidance relating to circumstances pursuant to the Corporations Act 2001 relating to the financial reporting framework. This framework enables the preparation of the financial report that gives a true and fair view (or is presented fairly, in all material respects).

REMINDER TO DRAFTER: CHECK APPLICABILITY

Compliance with this Auditing Standard enables compliance with ~~ISA~~ISA 315 (Redrafted).

Appendix 1

(Ref: Para. . 4(c), 14-23 and A65-A97)

Internal Control Components

1. This appendix further explains the components of internal control, as set out in paragraphs 4(c), 14-23 and A65-A97, as they relate to a financial statement audit.

Control Environment

2. The control environment encompasses the following elements:
 - (a) *Communication and enforcement of integrity and ethical values.* The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical ~~behavior~~behaviour are the product of the entity's ethical and ~~behavior~~behavioural standards, how they are communicated, and how they are reinforced in practice. The enforcement of integrity and ethical values includes, for example, management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts. The communication of entity policies on integrity and ethical values may include the communication of ~~behavior~~behavioural standards to personnel through policy statements and codes of conduct and by example.
 - (b) *Commitment to competence.* Competence is the knowledge and skills necessary to accomplish tasks that define the individual's job.
 - (c) *Participation by those charged with governance.* An entity's control consciousness is influenced significantly by those charged with governance. The importance of the responsibilities of those charged with governance is recognized in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance. Other responsibilities of those charged with governance include oversight of the design and effective operation of whistle blower procedures and

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the process for reviewing the effectiveness of the entity's internal control.

- (d) *Management's philosophy and operating style.* Management's philosophy and operating style encompass a broad range of characteristics. For example, management's attitudes and actions toward financial reporting may manifest themselves through conservative or aggressive selection from available alternative accounting principles, or conscientiousness and conservatism with which accounting estimates are developed.
- (e) ~~Organization~~*Organisational structure.* Establishing a relevant ~~organization~~*organisational* structure includes considering key areas of authority and responsibility and appropriate lines of reporting. The appropriateness of an entity's ~~organization~~*organisational* structure depends, in part, on its size and the nature of its activities.
- (f) *Assignment of authority and responsibility.* The assignment of authority and responsibility may include policies relating to appropriate business practices, knowledge and experience of key personnel, and resources provided for carrying out duties. In addition, it may include policies and communications directed at ensuring that all personnel understand the entity's objectives, know how their individual actions interrelate and contribute to those objectives, and recognize how and for what they will be held accountable.
- (g) *Human resource policies and practices.* Human resource policies and practices often demonstrate important matters in relation to the control consciousness of an entity. For example, standards for recruiting the most qualified individuals – with emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical ~~behavior~~*behaviour* – demonstrate an entity's commitment to competent and trustworthy people. Training policies that communicate prospective roles and responsibilities and include practices such as training

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- *New or revamped information systems.* Significant and rapid changes in information systems can change the risk relating to internal control.
- *Rapid growth.* Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.
- *New technology.* Incorporating new technologies into production processes or information systems may change the risk associated with internal control.
- *New business models, products, or activities.* Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with internal control.
- *Corporate restructurings.* Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with internal control.
- *Expanded foreign operations.* The expansion or acquisition of foreign operations carries new and often unique risks that may affect internal control, for example, additional or changed risks from foreign currency transactions.
- *New accounting pronouncements.* Adoption of new accounting principles or changing accounting principles may affect risks in preparing ~~the financial statements~~financial report.

Information System, Including the Related Business Processes, Relevant To Financial Reporting, And Communication

5. An information system consists of infrastructure (physical and hardware components), software, people, procedures, and data.

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Many information systems make extensive use of information technology (IT).

6. The information system relevant to financial reporting objectives, which includes the financial reporting system, encompasses methods and records that:
- Identify and record all valid transactions.
 - Describe on a timely basis the transactions in sufficient detail to permit proper classification of transactions for financial reporting.
 - Measure the value of transactions in a manner that permits recording their proper monetary value in the ~~financial statements~~ financial report.
 - Determine the time period in which transactions occurred to permit recording of transactions in the proper accounting period.
 - Present properly the transactions and related disclosures in the ~~financial statements~~ financial report.
7. The quality of system-generated information affects management's ability to make appropriate decisions in managing and controlling the entity's activities and to prepare reliable financial reports.
8. Communication, which involves providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting, may take such forms as policy manuals, accounting and financial reporting manuals, and memoranda. Communication also can be made electronically, orally, and through the actions of management.

Control Activities

9. Generally, control activities that may be relevant to an audit may be categorized as policies and procedures that pertain to the following:

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- *Performance reviews.* These control activities include reviews and analyses of actual performance versus budgets, forecasts, and prior period performance; relating different sets of data – operating or financial – to one another, together with analyses of the relationships and investigative and corrective actions; comparing internal data with external sources of information; and review of functional or activity performance.
- *Information processing.* The two broad groupings of information systems control activities are application controls, which apply to the processing of individual applications, and general IT-controls, which are policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. Examples of application controls include checking the arithmetical accuracy of records, maintaining and reviewing accounts and trial balances, automated controls such as edit checks of input data and numerical sequence checks, and manual follow-up of exception reports. Examples of general IT-controls are program change controls, controls that restrict access to programs or data, controls over the implementation of new releases of packaged software applications, and controls over system software that restrict access to or monitor the use of system utilities that could change financial data or records without leaving an audit trail.
- *Physical controls.* Controls that encompass:
 - The physical security of assets, including adequate safeguards such as secured facilities over access to assets and records.
 - The authorization for access to computer programs and data files.
 - The periodic counting and comparison with amounts shown on control records (for example

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comparing the results of cash, security and inventory counts with accounting records).

The extent to which physical controls intended to prevent theft of assets are relevant to the reliability of financial statement preparation, and therefore the audit, depends on circumstances such as when assets are highly susceptible to ~~mis~~appropriation.

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

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

Monitoring of Controls

11. An important management responsibility is to establish and maintain internal control on an ongoing basis. Management's monitoring of controls includes considering whether they are operating as intended and that they are modified as appropriate for changes in conditions. Monitoring of controls may include activities such as management's review of whether bank reconciliations are being prepared on a timely basis, internal auditors' evaluation of sales personnel's compliance with the entity's policies on terms of sales contracts, and a legal department's oversight of compliance with the entity's ethical or business practice policies. Monitoring is done also to ensure that controls continue to operate effectively over time. For example, if the timeliness and accuracy of bank reconciliations are not monitored, personnel are likely to stop preparing them.

Appendix 2

(Ref: Para. (Ref: Para. A29 and A108))

Conditions and Events that May Indicate Risks of Material Misstatement

The following are examples of conditions and events that may indicate the existence of risks of material misstatement. The examples provided cover a broad range of conditions and events; however, not all conditions and events are relevant to every audit engagement and the list of examples is not necessarily complete.

- Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies.
- Operations exposed to volatile markets, for example, futures trading.
- Operations that are subject to a high degree of complex regulation.
- Going concern and liquidity issues including loss of significant customers.
- Constraints on the availability of capital and credit.
- Changes in the industry in which the entity operates.
- Changes in the supply chain.
- Developing or offering new products or services, or moving into new lines of business.
- Expanding into new locations.
- Changes in the entity such as large acquisitions or re~~organization~~organisations or other unusual events.
- Entities or business segments likely to be sold.
- The existence of complex alliances and joint ventures.

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

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Appendix 3

(Ref: Para.)

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Appendix 2

(Ref: Para.)

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Tables of Differences — ASA [315315315](#) (Revised and Redrafted) and Extant ASA [315315315](#)

Base Standard

~~ISA~~ASA 315 (Redrafted) (*Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*) is used as the base standard for the purpose of re-drafting this proposed ASA. The base standard has been amended to account for the following matters:

- Australian Laws and Regulations;
- Changes considered necessary because the Auditing Standard is a legislative instrument made under the *Corporations Act 2001*; and
- Changes considered necessary in the public interest.

Summary of Main Differences — ASA [315315315](#) and Extant ASA [315315315](#)

The table below details the main differences between the proposed standard and extant ASA 315 (excluding editorial amendments):

ISA Requirements not in Extant ASA

<u>Item #</u>	<u>ISA Para. #</u>	<u>ISA Requirements (Copy/extract from Standard)</u>	<u>Commentary</u>
<u>Objectives</u>			
<u>1</u>	<u>3.</u>	<u>The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity’s internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.</u>	<p><u>New Objectives(s) included in ISA</u></p> <p><u>Not inconsistent with Australian practice or existing concepts in other ASAs.</u></p> <p><u>Suggest adopt ISA.</u></p>

<u>Item #</u>	<u>ISA Para. #</u>	<u>ISA Requirements (Copy/extract from Standard)</u>	<u>Commentary</u>
<u>Definitions</u>			
<u>2</u>	<u>4.</u>	<p><u>(a) Assertions – Representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.</u></p> <p><u>(b) Business risk – A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity’s ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.</u></p> <p><u>(c) Internal control – The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term “controls” refers to any aspects of one or more of the components of internal control.</u></p> <p><u>(d) Risk assessment procedures – The audit procedures performed to obtain an understanding of the entity and its environment, including the entity’s internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.</u></p> <p><u>(e) Significant risk – An identified and assessed risk of material misstatement that, in the auditor’s judgment, requires special audit consideration.</u></p>	<p><u>5 Definitions (a) – (d) included in ISA Standard.</u></p> <p><u>Not inconsistent with Australian practice or existing concepts in other ASAs.</u></p> <p><u>Suggest adopt ISA.</u></p> <p><u>Additionally, shaded text in (c) is Elevation of ASA Explanatory Guidance in [para 54].</u></p> <p><u>Suggest adopt ISA.</u></p>
<u>Risk Assessment Procedures and Related Activities</u>			
<u>3</u>	<u>5.</u>	<p><u>The auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Ref: Para. A1-A5)</u></p>	<p><u>NEW REQUIREMENT 1</u></p> <p><u>Shaded text is Elevation of Extant ASA Explanatory Guidance. Text represents a Basic principle that is not inconsistent with Australian practice.</u></p> <p><u>[Extant ASA 315 para 4, 7, 9 —equivalent Explanatory Guidance]</u></p>

<u>Item #</u>	<u>ISA Para. #</u>	<u>ISA Requirements (Copy/extract from Standard)</u>	<u>Commentary</u>
			<u>Suggest adopt ISA.</u>
4	6. (a)	<p>The risk assessment procedures shall include the following:</p> <p>(a) <u>Inquiries of management, and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. (Ref: Para. A6)</u></p>	<p><u>NEW REQUIREMENT 2</u></p> <p><u>Shaded text is Elevation of Extant ASA Explanatory Guidance [Extant ASA 315 para 13—equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA</u></p>
5	7.	<p><u>The auditor shall consider whether information obtained from the auditor's client acceptance or continuance process is relevant to identifying risks of material misstatement.</u></p>	<p><u>NEW REQUIREMENT 3</u></p> <p><u>Elevation of Extant ASA Explanatory Guidance [Extant ASA 315 para 19—equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>
6	8.	<p><u>Where the engagement partner has performed other engagements for the entity, the engagement partner shall consider whether information obtained is relevant to identifying risks of material misstatement.</u></p>	<p><u>NEW REQUIREMENT 4</u></p> <p><u>Elevation of Extant ASA Explanatory Guidance [Extant ASA 315 para 19—equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>

<u>Item #</u>	<u>ISA Para. #</u>	<u>ISA Requirements (Copy/extract from Standard)</u>	<u>Commentary</u>
<u>The Required Understanding of the Entity and its Environment, Including the Entity's Internal Control</u>			
5	11.	<p>The nature of the entity, including.....</p> <p>(i) Its operations;</p> <p>(ii) Its ownership and governance structures;</p> <p>(iii) The types of investments that the entity is making and plans to make; and</p> <p>(iv) The way that the entity is structured and how it is financed, to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements. (Ref: Para. A21-A23)</p>	<p><u>NEW REQUIREMENT 5</u></p> <p><u>Shaded text is Elevation of Extant ASA Explanatory Guidance</u></p> <p><u>[Extant ASA 315 para 33—equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>
6	12.	<p>..... Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit. (Ref: Para. A38-A61)</p>	<p><u>NEW REQUIREMENT 6</u></p> <p><u>Elevation of Extant ASA Explanatory Guidance</u></p> <p><u>[Extant ASA 315 para 60—equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>
7	13.	<p>When obtaining an understanding of controls that are relevant to the audit, the auditor shall evaluate the design of those controls and determine whether they have been implemented, by performing procedures in addition to inquiry of the entity's personnel. (Ref: Para. A62-A64)</p>	<p><u>NEW REQUIREMENT 7</u></p> <p><u>Shaded text is Elevation of Extant ASA Explanatory Guidance</u></p> <p><u>[Extant ASA 315 para 67—equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>

Item #	ISA Para. #	ISA Requirements (Copy/extract from Standard)	Commentary
8	14.	<p><u>As part of obtaining this understanding, the auditor shall evaluate whether:</u></p> <p>(a) <u>Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behaviour; and</u></p> <p>(b) <u>The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control, and whether those other components are not undermined by control environment weaknesses. (Ref: Para. A65-A74)</u></p>	<p><u>NEW REQUIREMENT 8</u></p> <p><u>Elevation of Extant ASA Explanatory Guidance</u></p> <p><u>[Extant ASA 315 para 81 —equivalent Explanatory Guidance to para (a)]</u></p> <p><u>[Extant ASA 315 para 86 —equivalent Explanatory Guidance to para (b)]</u></p> <p><u>Suggest adopt ISA.</u></p>
9	15.	<p><u>The auditor shall obtain an understanding of whether the entity has a process for:</u></p> <p>(a) <u>Identifying business risks relevant to financial reporting objectives;</u></p> <p>(b) <u>Estimating the significance of the risks;</u></p> <p>(c) <u>Assessing the likelihood of their occurrence; and</u></p> <p>(d) <u>Deciding about actions to address those risks. (Ref: Para. A75)</u></p>	<p><u>NEW REQUIREMENT 9</u></p> <p><u>Shaded text is Elevation of Extant ASA Explanatory Guidance</u></p> <p><u>[Extant ASA 315 para 91 —equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>
10	16.	<p><u>If the entity has established such a process (referred to hereafter as the ‘entity’s risk assessment process’), the auditor shall obtain an understanding of it, and the results thereof. Where the auditor identifies risks of material misstatement that management failed to identify, the auditor shall evaluate whether there was an underlying risk of a kind that the auditor expects would have been identified by the entity’s risk assessment process. If there is such a risk, the auditor shall obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or if there is a material weakness in the entity’s risk assessment process.</u></p>	<p><u>NEW REQUIREMENT 10</u></p> <p><u>Elevation of (ISA) Explanatory Guidance</u></p> <p><u>[Extant ASA 315 para 92 —equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>

Item #	ISA Para. #	ISA Requirements (Copy/extract from Standard)	Commentary
11	17.	<p>If the entity has not established such a process or has an ad hoc process, the auditor shall discuss with management whether business risks relevant to financial reporting objectives have been identified and how they have been addressed.</p>	<p><u>NEW REQUIREMENT 11</u></p> <p><u>Elevation of Extant ASA Explanatory Guidance</u></p> <p><u>[Extant ASA 315 para 91—equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>
12	17.	<p>The auditor shall evaluate whether the absence of a documented risk assessment process is appropriate in the circumstances, or represents a material weakness in the entity’s internal control. (Ref: Para. A76)</p>	<p><u>NEW REQUIREMENT 12</u></p> <p><u>New Requirement with no Extant ASA equivalent.</u></p> <p><u>Not inconsistent with Australian practice.</u></p> <p><u>Suggest adopt ISA.</u></p>
13	18.	<p>The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas:.....</p> <p>(b) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;</p> <p>(c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;.....</p> <p>(f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments. (Ref: Para. A77-A81)</p>	<p><u>NEW REQUIREMENT 13</u></p> <p><u>Shaded text at (b) is New Requirement with no Extant ASA equivalent..</u></p> <p><u>Not inconsistent with Australian practice.</u></p> <p><u>Suggest adopt ISA.</u></p> <p><u>Shaded text at (c) is Elevation of Extant ASA Explanatory Guidance</u> <u>[Extant ASA 315 para 96(a)—equivalent Explanatory Guidance]</u></p> <p><u>Shaded text at (f) is Elevation of Extant ASA Explanatory Guidance</u> <u>[Extant ASA 315 para 97/98—equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>

<u>Item #</u>	<u>ISA Para. #</u>	<u>ISA Requirements (Copy/extract from Standard)</u>	<u>Commentary</u>
14	19	<p>The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities and significant matters relating to financial reporting, including:</p> <p>(a) Communications between management and those charged with governance; and</p> <p>(b) External communications, such as those with regulatory authorities. (Ref: Para. A82-A83)</p>	<p><u>NEW REQUIREMENT 14</u></p> <p>Shaded text is Elevation of Extant ASA Explanatory Guidance [Extant ASA 315 para 104 —equivalent Explanatory Guidance]</p> <p>Suggest adopt ISA.</p>
15	20.	<p>.....An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them. (Ref: Para. A84-A90)</p>	<p><u>NEW REQUIREMENT 15</u></p> <p>Elevation of Extant ASA Explanatory Guidance [Extant ASA 315 para 107 —equivalent Explanatory Guidance]</p> <p>Suggest adopt ISA.</p>
16	23.	<p>The auditor shall obtain an understanding of the sources of the information used in the entity’s monitoring activities, and the basis upon which management considers the information to be sufficiently reliable for the purpose. (Ref: Para. A97)</p>	<p><u>NEW REQUIREMENT 16</u></p> <p>Elevation of Extant ASA Explanatory Guidance [Extant ASA 315 para 116 —equivalent Explanatory Guidance]</p> <p>Suggest adopt ISA.</p>
<u>Identifying and Assessing the Risks of Material Misstatement</u>			
17	24.	<p>The auditor shall identify and assess the risks of material misstatement at:</p> <p>(a) The financial statement level; and (Ref: Para. A98-A101)</p> <p>(b) The assertion level for classes of transactions, account balances, and disclosures, (Ref: Para. A102-A106)</p> <p>to provide a basis for designing and performing further audit procedures.</p>	<p><u>NEW REQUIREMENT 17</u></p> <p>Shaded text is Elevation of Extant ASA Explanatory Guidance [Extant ASA 315 para 119 —equivalent Explanatory Guidance]</p> <p>Suggest adopt ISA.</p>

<u>Item #</u>	<u>ISA Para. #</u>	<u>ISA Requirements (Copy/extract from Standard)</u>	<u>Commentary</u>
<u>18</u>	<u>25.</u>	<p><u>For this purpose, the auditor shall:</u></p> <p>(a) <u>Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements; Ref: Para. A107-A108)</u></p> <p>(b) <u>Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;</u></p> <p>(c) <u>Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: Para. A109-A111)</u></p> <p>(d) <u>Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.</u></p>	<p><u>NEW REQUIREMENT 18</u></p> <p><u>Shaded text is Elevation of Extant ASA Explanatory Guidance [Extant ASA 315 para 118 —equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p> <p><u>NEW REQUIREMENT 19</u></p> <p><u>Unshaded text in (b), (c), and (d) is New Requirement with no Extant ASA equivalent.</u></p> <p><u>No equivalent Extant ASA Requirement or Explanatory Guidance. Not inconsistent with Australian practice.</u></p> <p><u>Suggest adopt ISA.</u></p>
<u>19</u>	<u>26.</u>	<p><u>As part of the risk assessment as described in paragraph 24, the auditor shall determine whether any of the risks identified are, in the auditor’s judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.</u></p>	<p><u>NEW REQUIREMENT 20</u></p> <p><u>Shaded text is Elevation of Extant ASA Explanatory Guidance [Extant ASA 315 para 128 —equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>
<u>19</u>	<u>27.</u>	<p><u>In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:</u></p> <p>(a) <u>Whether the risk is a risk of fraud;</u></p> <p>(b) <u>Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;</u></p> <p>(c) <u>The complexity of transactions;</u></p>	<p><u>NEW REQUIREMENT 21</u></p> <p><u>Elevation of (ISA) Explanatory Guidance [Extant ASA 315 para 128 —equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>

<u>Item #</u>	<u>ISA Para. #</u>	<u>ISA Requirements (Copy/extract from Standard)</u>	<u>Commentary</u>
		<p><u>(d) Whether the risk involves significant transactions with related parties;</u></p> <p><u>(e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and</u></p> <p><u>(f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual. (Ref: Para. A112-A116)</u></p>	
<u>20</u>	<u>29.</u>	<p><u>In respect of some risks, the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention.</u></p>	<p><u>NEW REQUIREMENT 22</u></p> <p><u>Shaded text is Elevation of Extant ASA Explanatory Guidance</u></p> <p><u>[Extant ASA 315 para 137 and 138 —equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>
<u>21</u>	<u>30.</u>	<p><u>The auditor’s assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment, the auditor shall revise the assessment and modify the further planned audit procedures accordingly. (Ref: Para. A123)</u></p>	<p><u>NEW REQUIREMENT 23</u></p> <p><u>Shaded text is Elevation of Extant ASA Explanatory Guidance</u></p> <p><u>[Extant ASA 315 para 140 —equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>

<u>Item #</u>	<u>ISA Para. #</u>	<u>ISA Requirements (Copy/extract from Standard)</u>	<u>Commentary</u>
<u>Material Weakness in Internal Control</u>			
<u>22</u>	<u>31.</u>	The auditor shall evaluate whether, on the basis of the audit work performed, the auditor has identified a material weakness in the design, implementation or maintenance of internal control. (Ref: Para. A124-A125)	<p><u>NEW REQUIREMENT 24</u></p> <p><u>Elevation of Extant ASA Explanatory Guidance</u></p> <p><u>[Extant ASA 315 para 142] — contains equivalent Explanatory Guidance except for the shaded text . ISA text is more comprehensive than Extant ASA, but is consistent with Extant ASA 700 - The Independent Auditor’s Report on General Purpose Financial Statements [ASA 700, para 5. (c)], which is a more recently drafted ASA.</u></p> <p><u>Not inconsistent with Australian practice.</u></p> <p><u>Suggest Adopt ISA</u></p>
<u>23</u>	<u>32.</u>	The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility, and , as required by ISA 260 (Revised), “Communication with Those Charged with Governance,” with those charged with governance (unless all of those charged with governance are involved in managing the entity). (Ref: Para. A126)	<p><u>NEW REQUIREMENT 25</u></p> <p><u>Shaded text is New Requirement with no Extant ASA equivalent..</u></p> <p><u>No equivalent Extant ASA Requirement or Explanatory Guidance. Not inconsistent with Australian practice.</u></p> <p><u>Suggest adopt ISA.</u></p> <p><u>Underlined text is more comprehensive than ASA equivalent as it is not limited to weaknesses in design or implementation of internal controls.</u></p> <p><u>[Extant ASA 315 para 141]:</u> <u>“The auditor shall make those charged with governance or management aware, as soon as practicable, and at an appropriate level of responsibility, of material weaknesses in the design or</u></p>

<u>Item #</u>	<u>ISA Para. #</u>	<u>ISA Requirements (Copy/extract from Standard)</u>	<u>Commentary</u>
			<p><u>implementation of internal control which have come to the auditor's attention"</u></p> <p><u>ISA text is not inconsistent with Extant ASA 700 [see 5. (c)], which is a more recently drafted ASA. Therefore it is not inconsistent with Australian practice.</u></p> <p><u>Suggest adopt ISA.</u></p> <p><u>Bolded Text is elevation of Extant ASA Explanatory Guidance. [Extant ASA 315, para 142 - — contains equivalent Explanatory Guidance]</u></p> <p><u>Suggest adopt ISA.</u></p>

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Extant ASA Requirements not in ISA

<u>Item #</u>	<u>ASA Para. #</u>	<u>ASA Requirement (Copy/extract from Standard)</u>	<u>Commentary</u>
<u>Not Retained in ASA (Revised & Redrafted)</u>			
<u>Communicating with Those Charged with Governance and Management</u>			
1	141.	<p>The auditor shall make those charged with governance or management aware, as soon as practicable, and at an appropriate level of responsibility, of material weaknesses in the design or implementation of internal control which have come to the auditor's attention.</p>	<p>ISA equivalent wording to the shaded text is: <u>“The auditor shall evaluate whether, on the basis of the audit work performed, the auditor has identified a material weakness in the design, implementation or maintenance of internal control. (Ref: Para. A124-A125)”</u> [Ref: ISA 315: para 31]</p> <p><u>And</u></p> <p><u>“The auditor shall communicate material weaknesses in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility, and, as required by ISA 260 (Revised), “Communication with Those Charged with Governance,” with those charged with governance (unless all of those charged with governance are involved in managing the entity). (Ref: Para. A126)”</u> [Ref: ISA 315: para 32]</p> <p>ISA paragraphs contain basic principles which are not inconsistent with Australian practice or Extant ASA 700.</p> <p>Suggest adopt ISA.</p>

<u>Item #</u>	<u>ASA Para. #</u>	<u>ASA Requirement (Copy/extract from Standard)</u>	<u>Commentary</u>
2	143	<p>The auditor shall document: (a) the discussion among the engagement team regarding the susceptibility of the entity’s financial report to material misstatement due to error or fraud, and the significant decisions reached;.....</p>	<p><u>ISA equivalent wording to the shaded text is:</u></p> <p>“The auditor shall document: (a) The discussion among the engagement team where required by <i>paragraph 10</i>, and the significant decisions reached;....” [Ref: ISA 315: para 33]</p> <p>Where [para 10] text is: “The engagement partner and other key engagement team members shall discuss the susceptibility of the entity’s financial statements to material misstatement, and the application of the applicable financial reporting framework to the entity’s facts and circumstances. The engagement partner shall determine which matters are to be communicated to engagement team members not involved in the discussion. (Ref: Para. A12-A14)” [Ref: ISA 315: para 10]</p> <p>ISA 315 makes no direct reference to error or fraud, however this is implied throughout the standard through the definition of ‘Risk Assessment Procedures’: “4. For purposes of the ISAs, the following terms have the meanings attributed below: (d) Risk assessment procedures – The audit procedures performed to obtain an understanding of the entity and its environment, including the entity’s internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.” [Ref: ISA 315: para 4 (d)]</p> <p>Accept ISA as ISA paragraphs contains wording which has equivalent meaning. Not inconsistent with Australian practice.</p> <p><u>Suggest adopt ISA.</u></p>

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Guidance—Significant Differences

<u>Item</u> <u>#</u>	<u>ISA/ASA</u> <u>Para.</u> <u>#</u>	<u>Guidance</u> <u>(Copy/extract from Standard)</u>	<u>Commentary</u>
<u>PART A – ISA</u>			
<u>Risk Assessment Procedures and Related Activities</u>			
1	A9.	<p><u>Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment. Examples of such audit procedures include observation or inspection of the following....:</u></p>	<p><u>Equivalent Explanatory Guidance text in ASA 315 [para 16] includes the use of the word “ordinarily”:</u></p> <p><u>“Observation and inspection may support enquiries of those charged with governance, management and others, and also provide information about the entity and its environment. Such audit procedures ordinarily include the following....”</u></p> <p><u>Suggest adopt ISA.</u></p>
<u>Identifying and Assessing the Risks of Material Misstatement – The Use of Assertions</u>			
2	A102-A105	<p><u>A102 Risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. In identifying and assessing risks of material misstatement at the assertion level, the auditor may conclude that the identified risks relate more pervasively to the financial statements as a whole and potentially affect many assertions.</u></p> <p><u>A103. In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation and disclosure of the various elements of financial statements and related</u></p>	<p><u>Explanatory Guidance in ISA is not contained in Extant ASA 315, however is equivalent to Guidance in Extant ASA 500 Audit Evidence [para 22]</u></p> <p><u>Quality of standard would be reduced if this guidance is removed. This guidance does not conflict with Australian practice.</u></p> <p><u>Suggest adopt ISA.</u></p>

<p><u>Item</u> <u>#</u></p>	<p><u>ISA/ASA</u> <u>Para.</u> <u>#</u></p>	<p><u>Guidance</u> <u>(Copy/extract from Standard)</u></p>	<p><u>Commentary</u></p>
		<p><u>disclosures.</u></p> <p><u>A104. Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms:</u></p> <p><u>(a) Assertions about classes of transactions and events for the period under audit:</u></p> <ul style="list-style-type: none"> <u>(i) Occurrence—transactions and events that have been recorded have occurred and pertain to the entity.</u> <u>(ii) Completeness—all transactions and events that should have been recorded have been recorded.</u> <u>(iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately.</u> <u>(iv) Cutoff—transactions and events have been recorded in the correct accounting period.</u> <u>(v) Classification—transactions and events have been recorded in the proper accounts.</u> <p><u>(b) Assertions about account balances at the period end:</u></p> <ul style="list-style-type: none"> <u>(i) Existence—assets, liabilities, and equity interests exist.</u> <u>(ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.</u> <u>(iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded.</u> <u>(iv) Valuation and allocation—assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.</u> <p><u>(c) Assertions about presentation and disclosure:</u></p> <ul style="list-style-type: none"> <u>(i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.</u> <u>(ii) Completeness—all disclosures that should have been included in the financial statements have been included.</u> <u>(iii) Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.</u> 	

<u>Item #</u>	<u>ISA/ASA Para. #</u>	<u>Guidance (Copy/extract from Standard)</u>	<u>Commentary</u>
		<p>(iv) <u>Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.</u></p> <p><u>A105. The auditor may use the assertions as described above or may express them differently provided all aspects described above have been covered. For example, the auditor may choose to combine the assertions about transactions and events with the assertions about account balances.</u></p>	
<u>Documentation</u>			
<u>3</u>	<u>A129</u>	<u>The extent of documentation may also reflect the experience and capabilities of the members of the audit engagement team. Provided the requirements of ISA 230, “Audit Documentation,” are always met, an audit undertaken by an engagement team comprising less experienced individuals may require more detailed documentation to assist them to obtain an appropriate understanding of the entity than one that includes experienced individuals.</u>	<p><u>New Explanatory Guidance in ISA</u></p> <p><u>Quality of standard would be reduced if this guidance is removed. This guidance does not conflict with Australian practice.</u></p> <p><u>Suggest adopt ISA.</u></p>
<u>4</u>	<u>A130</u>	<u>For recurring audits, certain documentation may be carried forward, updated as necessary to reflect changes in the entity’s business or processes.</u>	<p><u>New Explanatory Guidance in ISA</u></p> <p><u>Quality of standard would be reduced if this guidance is removed. This guidance does not conflict with Australian practice.</u></p> <p><u>Suggest adopt ISA.</u></p>
<u>Risk Assessment Procedures and Related Activities</u>			
<u>5</u>	<u>A14.</u>	<u>Many small audits are carried out entirely by the engagement partner (who may be a sole practitioner). In such situations, it is the engagement partner who, having personally conducted the planning of the audit, would be responsible for considering the susceptibility of the entity’s financial statements to material misstatement due to fraud or error.</u>	<p><u>New Explanatory Guidance in ISA</u></p> <p><u>Quality of standard would be reduced if this guidance is removed. This guidance does not conflict with Australian practice.</u></p> <p><u>Suggest adopt ISA.</u></p>

<u>Item #</u>	<u>ISA/ASA Para. #</u>	<u>Guidance (Copy/extract from Standard)</u>	<u>Commentary</u>
<u>PART B – ASA</u>			
<u>Retained in ASA (Revised & Redrafted)</u> <u>Reason 3: [Only when requirement necessary for public interest reasons and no inconsistency with the ISA]</u>			
<u>Risk Assessment Procedures and Related Activities – Observation and Inspection</u>			
6	16.	<p><u>Observation and inspection may support enquiries of those charged with governance, management and others, and also provide information about the entity and its environment. Such audit procedures ordinarily include the following:</u></p> <ul style="list-style-type: none"> • <u>Observation of entity activities and operations.</u> • <u>Inspection of documents (such as business plans and strategies), records, and internal control manuals.</u> • <u>Reading reports prepared by management (such as quarterly management reports and interim financial report) and those charged with governance (such as minutes of board of directors’ meetings).</u> • <u>Visits to the entity’s premises and plant facilities.</u> • <u>Tracing transactions through the information system relevant to financial reporting (walk-throughs).</u> 	<p><u>Shaded text is not included in ISA</u></p> <p><u>Suggest Extant ASA Explanatory Guidance retained as it contributes to the quality of the standard and is in the public interest.</u></p> <p><u>Not inconsistent with the ISA. [Refer Para 315. A9]</u></p> <p><u>Suggest Retain ASA wording.</u></p>

<u>Item #</u>	<u>ISA/ASA Para. #</u>	<u>Guidance (Copy/extract from Standard)</u>	<u>Commentary</u>
<u>Controls relevant to the Audit</u>			
7	60.	Ordinarily, controls that are relevant to an audit pertain to the entity’s objective of preparing a financial report for external purposes that gives a true and fair view (or is presented fairly, in all material respects) in accordance with the applicable financial reporting framework and the management of risk that may give rise to a material misstatement in that financial report.	<p>Shaded text is not included in ISA</p> <p>Suggest Guidance retained as it is relevant to Australian Regulatory requirements of the <i>Corporations Act 2001</i>.</p> <p>Not inconsistent with the equivalent ISA. [Refer Para 315. A42]: “Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity’s financial reporting objectives.”</p> <p>Suggest re-word of [para A42] to include ASA wording as follows: “Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity’s financial reporting objective of preparing a financial report for external purposes that gives a true and fair view (or is presented fairly, in all material respects) in accordance with the applicable financial reporting framework.”</p> <p>Suggest Retain ASA wording with [para A42] amendments.</p>
<u>Control Environment</u>			
8	85	<p>..... In understanding the design of the control environment, ordinarily the auditor considers:</p> <p>.....(b) whether there is an audit committee that understands the entity’s business transactions and evaluates whether the financial report gives a true and fair view (or is presented fairly, in all material respects) in accordance with the applicable financial reporting framework.</p>	<p>Shaded text is not included in ISA</p> <p>Suggest Guidance retained as it is relevant to Australian Regulatory requirements of the <i>Corporations Act 2001</i>.</p> <p>Not inconsistent with the equivalent ISA. [Refer Para 315. para A68]: “The effectiveness of the design of the control environment in relation to participation by those charged with governance is therefore influenced by such matters as:.....</p>

<u>Item #</u>	<u>ISA/ASA Para. #</u>	<u>Guidance (Copy/extract from Standard)</u>	<u>Commentary</u>
			<ul style="list-style-type: none"> • <u>The extent to which they evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework.”</u> <p><u>Suggest re-word of [para A68] to include ASA wording as follows:</u></p> <ul style="list-style-type: none"> • <u>The extent to which they evaluate whether the financial statements report gives a true and fair view (or is presented fairly, in all material respects) in accordance with the applicable financial reporting framework.”</u> <p><u>Suggest Retain ASA wording with [para A68] amendments.</u></p>

Draft

EXHIBIT 4

Appendices—Significant Differences

<u>Item #</u>	<u>ISA/ASA Para.</u> #	<u>Appendix</u> <u>(Copy/extract from Standard)</u>	<u>Commentary</u>
<u>Part B – ASA</u>			
<u>Appendix 1 – Understanding the Entity and Its Environment</u>			
1	All	<i>Main content of wording in the Appendix</i>	<p><u>ASA Appendix 1 Explanatory Guidance is primarily contained in [ISA 315, para A22].</u></p> <p><u>Substantial change to numbering and sequence would be required to adjust Guidance section. As text is the substantially the same and retains its Explanatory Guidance status, suggest leave Explanatory Guidance as part of A22 and not a separate Appendix.</u></p> <p><u>Suggest adopt ISA.</u></p> <p><u>Content not included in ISA 315, para A22 is as follows:</u></p> <p><u>1. Ownership and Governance Arrangement matters are not included at all:</u></p> <p><u>“Ownership and Governance Arrangements</u></p> <ul style="list-style-type: none"> <u>• The role of the board of directors and those charged with governance in determining policies for the levels of risk that the entity is willing to accept in its daily operations.</u> <u>• The role of senior management in designing, implementing, and monitoring effective risk management systems to implement the policies prescribed by the board of directors.</u>

		<p style="font-size: 48pt; color: gray; opacity: 0.5;">Draft</p>	<ul style="list-style-type: none"> • <u>The presence of non-executive directors on the board and independent compensation committee that reviews incentive plans, including commissions, discretionary bonuses, directors’ service contracts, and profit-sharing plans.</u> • <u>The role of line management in carrying out the prescribed procedures and control activities.</u> • <u>The strength of the internal audit function and the audit committee and their role as an independent appraisal function.</u> • <u>The strength of other significant committees, for example, risk management committee, asset and liability management committee, or general management committee.</u> • <u>The adequacy of segregation of duties.”</u> <p><u>Quality of standard would be reduced if the Guidance removed, as it is useful. Not inconsistent with the equivalent ISA</u></p> <p><u>Suggest Retain ASA wording with [para A22] amendments to include text as noted above.</u></p>
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			<p><u>2. ‘Financial Reporting matters’ section does not include:</u></p> <ul style="list-style-type: none"> • <u>“Financial report presentation and disclosure.”</u> <p><u>Quality of standard would be reduced if the Guidance removed, as it is useful. Not inconsistent with the equivalent ISA</u></p> <p><u>Suggest Retain ASA wording with [para A22] amendments as follows:</u></p> <ul style="list-style-type: none"> • <u>“Prior period Financial reporting disclosures including form, classifications, terminology used, basis of amounts and level of detail provided”</u> <p><u>Note: The above suggested wording is blended from ASA 315 Appendix 1 and ASA Explanatory Guidance [para 38]:</u> <u>“The presentation of a financial report in conformity with the applicable financial reporting framework includes adequate disclosure of material matters. These matters relate to the form, arrangement, and content of the financial report and its appended notes, including, for example, the terminology used, the amount of detail given, the classification of items in the report, and the basis of amounts set forth. Ordinarily, the auditor considers whether the entity has disclosed a particular matter appropriately in light of the circumstances and facts of which the auditor is aware at the time.”</u></p> <p><u>Suggest Retain ASA through amendments to [para A22].</u></p>
<p><u>Appendix 2 – Internal Control Components</u></p>			
<p><u>2</u></p>	<p><u>Components</u></p>	<p><u>Main content of wording in the Appendix</u></p>	<p><u>ASA Appendix 1 Explanatory Guidance is primarily contained in ISA’s Explanatory Guidance section or in ISA Appendix 1.</u></p> <p><u>Substantial change to numbering and sequence would be required to adjust Guidance section. As text is the substantially the same and retains its Explanatory Guidance status, suggest leave Explanatory Guidance split within Explanatory Guidance section and ISA Appendix 1.</u></p> <p><u>Suggest adopt ISA.</u></p>

<p><u>3</u></p>	<p><u>(e)</u></p>	<p><u>For financial reporting purposes, the entity’s risk assessment process includes how management identifies risks relevant to the preparation of a financial report that gives a true and fair view (or is presented fairly, in all material respects) in accordance with the entity’s applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to manage them.</u></p>	<p><u>Shaded text not included in ISA, Appendix 1 – Internal Control Components.</u></p> <p><u>[Appendix 1 – Entity’s Risk Assessment Process, 3. (e)]:</u> <u>“For financial reporting purposes, the entity’s risk assessment process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity’s applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to respond to and manage them and the results thereof.”</u></p> <p><u>ASA wording is relevant to Australian Regulatory Requirements in the Corporations Act 2001 and suggest insertion of additional wording under the above paragraph [para 3 (e)] to address:</u></p> <p><u>“The applicable financial reporting framework is one that enables the preparation of the financial report that gives a true and fair view (or is presented fairly, in all material respects)”.</u></p> <p><u>Suggest Retain ASA wording through Appendix 1 amendments.</u></p>
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