



Agenda Item 3(a)
AUASB Meeting 31 July 2018

DRAFT

August 2018

Explanatory Memorandum

Exposure draft 01/18: Identifying and Assessing the Risks of Material Misstatement

Exposure draft 02/18: Proposed Auditing Standard ASA 2018-1 Amendments to Australian Auditing Standards

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



Obtaining a Copy of this Explanatory Memorandum

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

Contact Details

Auditing and Assurance Standards Board
Podium Level 14, 530 Collins Street
Melbourne Victoria 3000 AUSTRALIA

Phone: (03) 8080 7400
Fax: (03) 8080 7450
E-mail: enquiries@auasb.gov.au

Postal Address:
PO Box 204, Collins Street West
Melbourne Victoria 8007 AUSTRALIA

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Important Note and Disclaimer

This Explanatory Memorandum is issued by the AUASB to provide information to auditors and assurance practitioners about the AUASB's implementation in Australia of the IAASB's proposed ISA 315 *Identifying and Assessing the Risks of Material Misstatement* and Proposed Consequential and Conforming Amendments.

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

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EXPLANATORY MEMORANDUM

Exposure Draft: Identifying and Assessing the Risks of Material Misstatement

Purpose

1. The International Auditing and Assurance Standards Board (IAASB) have issued Exposure Draft ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement*, and conforming and consequential amendments.
2. The AUASB is seeking feedback from constituents on this ED to inform us when developing our response to the IAASB, and when considering whether there are any compelling reasons for the proposals to be modified for application in Australia.
3. The aim of this Explanatory Memorandum is to provide constituents with information about ED 01/18 ASA 315 *Identifying and Assessing the Risks of Material Misstatement* (ED 01/18), and ED 02/18 Proposed Auditing Standard ASA 2018-1 *Amendments to Australian Auditing Standards* (ED 02/18), and the Auditing and Assurance Standards Board's (AUASB) approach to implementing in Australia.

Composition of ED 01/18 and 02/18

4. ED 01/18 includes proposed amendments to ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.
5. ED 02/18 includes:
 - (a) the proposed conforming and consequential amendments to ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*, ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report* and ASA 330 *The Auditor's Response to Assessed Risks*.
 - (b) the proposed conforming and consequential amendments to other ASAs are detailed in Appendix 1.
6. Consequential and conforming amendments to ISA 540 (Revised) *Auditing Accounting Estimates and Related Disclosures* will be released by the IAASB once ISA 315 is released as a final standard.

Exposure Draft Questions

7. Constituents are asked to respond to questions:
 - (a) which the IAASB have requested feedback on, which will inform the AUASB when developing our response to the IAASB; and
 - (b) to assist the AUASB in assessing the impact of Australian applicable laws and regulations, and whether any compelling reasons exist, which would result in modifications to the final standard for application in Australia.
8. Refer to ED 01/18 and ED 02/18 for the detailed questions.

Background

IAASB

9. A strategic objective of the IAASB is to ensure the ISAs continue to form the basis for high quality, valuable and relevant audits conducted worldwide by responding on a timely basis to issues noted in practice and emerging developments.
10. ED 01/18 and ED 02/18 are part of the IAASB's commitment to advancing audit quality globally.
11. ED 01/18 proposes essential enhancements to the auditor's risk assessment process, with the objective of establishing more robust requirements and appropriately detailed guidance to drive auditors to perform consistent and effective identification and assessment of the risks of material misstatement.
12. The more significant changes proposed in ED 01/18 are:
 - a comprehensive introduction section which provides an overview of the key concepts including an overview of the risk assessment process
 - new definitions including the definitions of inherent risk factors, relevant assertions and significant risk
 - a new "stand-back" requirement to re-assess and confirm the appropriateness of the auditor's assessment of classes of transactions, account balances and disclosures that are quantitatively or qualitatively material, and that have not been identified as significant
 - a new requirement to separately assess inherent risk and control risk
 - enhanced guidance in relation to scalability
 - increased emphasis on professional scepticism and the auditor's considerations relating to fraud
 - enhanced requirements and application material in relation to identifying and assessing IT applications, the risks arising from IT and general IT controls relevant to the audit
 - new application material in relation to how automated tools and techniques may be used in the risk assessment process
 - extended application material to provide guidance to the requirements

13. Further details can be found on the IAASB's website: <http://www.ifac.org/auditing-assurance>
- Explanatory Memorandum – includes details on the background and the process adopted by the IAASB in developing ED-315 and the significant changes proposed.
 - Flowcharts which accompany ED-315.

[Exposure Draft, ISA 315 \(Revised\), Identifying and Assessing the Risks of Material Misstatement | IFAC](#)

AUASB

14. The AUASB has a strategic objective to develop, issue and maintain high quality Australian Auditing Standards. The AUASB takes input received from Australian constituents into account when preparing its submissions to the IAASB. The AUASB makes formal submissions on EDs issued by the IAASB to contribute to the setting of international auditing and assurance standards.
15. In accordance with its mandates under section 227 of the *ASIC Act 2001* and the Financial Reporting Council's (FRC) Strategic Direction, the AUASB's policy is to adopt the IAASB's auditing standards (ISAs), unless there are compelling reasons not to do so; and to amend the ISAs only when there are compelling reasons to do so. The AUASB's principles of convergence with the ISAs and harmonisation with the New Zealand auditing standards can be found on the AUASB's website:
- http://www.auasb.gov.au/admin/file/content102/c3/Aug14_IAASB-NZAuASB_Principles_of_Convergence_and_Harmonisation.pdf
16. Compelling reasons fall broadly into two categories: legal and regulatory; and principles and practices considered appropriate in maintaining or improving audit quality in Australia. Compelling reasons are further guided by the AUASB's policy of harmonisation with the standards of the New Zealand Auditing and Assurance Standards Board (NZAuASB).
17. The AUASB will adopt the revised ISA 315 into the Australian Auditing Standards that are made under section 336 of the *Corporations Act 2001*. Prior to implementation, the AUASB is required to consult with constituents and accordingly now issues Exposure Draft ED 01/18 and 02/18 for public exposure and comment. All comments received from constituents are considered by the AUASB when providing comments to the IAASB and prior to finalisation of the proposed revised standard.

The AUASB's approach

Exposure Draft Protocols

18. The AUASB has developed ED 01/18 and ED 02/18 based on the IAASB's equivalent ED-315. The AUASB is seeking feedback from constituents to inform us when responding to the IAASB on ED-315, and to identify compelling reasons when it is appropriate to amend ISA 315.
19. Under its convergence policies, the AUASB continues to include requirements and guidance that are in addition to, or a clarification of, the equivalent ISA, only when the compelling reason test has been met. Any such modifications continue to be identified in the Australian Auditing Standards by paragraph numbering commencing with an "Aus" prefix. Any such changes do not diminish the requirements of the equivalent ISA. Note that no compelling reasons have been identified to date by the AUASB Technical Group, and included in ED 01/18 and ED 02/18.
20. In addition to those changes that meet the compelling reason test, the AUASB makes format and terminology changes to comply with requirements relating primarily to legislative

instruments. Such changes are machinery in nature and do not change the meaning of the equivalent ISA.

General

21. The exposure drafts (EDs) will be open to constituents for a **70 day comment period** closing on 15 October 2018. This is to allow constituents time to respond to the AUASB on the EDs, and for the AUASB to conduct further outreach and to collate all feedback into our submission to the IAASB due on 2 November 2018.
22. At the completion of the exposure period, the AUASB will consider constituents' submissions:
 - (a) to inform us when developing our response to the IAASB on their ED; and
 - (b) where the AUASB determines that a compelling reason exist, to inform us as to whether modifications may be required when we are adopting the final standard.

Other Outreach Activities

23. In addition to the public exposure process, during September and October 2018 the AUASB will conduct roundtable consultative meetings and a webinar, in conjunction with the AUASB exposure draft ED 03/18 Proposed ASA 540 (Revised) *Auditing Accounting Estimates and Related Disclosures*.

Application

24. It is proposed that the revised standard will be applicable for financial reporting periods **beginning on or after 15 December 2020**. This application date corresponds with that of the equivalent ISA.

Early Adoption

25. Consistent with the IAASB's policy, all Australian Auditing Standards may be early adopted unless explicitly prohibited.

Website Resources

26. The AUASB welcomes constituents' input to the development of Australian Auditing Standards and regards both supportive and critical comments as essential to a balanced review of the proposed standards. Constituents are encouraged to access the websites of the [AUASB](#) and the [IAASB](#) to obtain further information.

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