

EXPOSURE DRAFT

ED 02/18
(August 2018)

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

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



Australian Government

Auditing and Assurance Standards Board

Commenting on this Exposure Draft

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

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Formal Submissions

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PREFACE

Reasons for Issuing ED 02/18

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

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

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

Main Proposals

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

- ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards* (Issued October 2009 and amended to December 2015);
- ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report* (Issued October 2009 and amended to May 2017); and
- ASA 330 *The Auditor's Responses to Assessed Risks* (Issued October 2009 and amended to December 2015).

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

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

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

Proposed Operative Date

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

Request for Comments

Comments are invited on this Exposure Draft of the proposed issuance of ASA 2018-1 *Amendments to Australian Auditing Standards* by no later than 15 October 2018. The AUASB is seeking comments from respondents on the following questions:

ED 02/18 Conforming and Consequential Amendments

The IAASB has asked for constituents views on:

1. With respect to the proposed conforming and consequential amendments to:
 - (a) ASA 200¹ and ASA 240, are these appropriate to reflect the corresponding changes made in proposed ASA 315?
 - (b) ASA 330, are the changes appropriate in light of the enhancements that have been made in proposed ASA 315, in particular as a consequence of the introduction of the concept of general IT controls relevant to the audit?
 - (c) The other ASAs as presented in Appendix 1, are these appropriate and complete?
2. Do you support the proposed revisions to paragraph 18 of ASA 330 to apply to classes of transactions, account balances or disclosures that are ‘quantitatively or qualitatively material’ to align with the scope of the proposed stand-back in proposed ASA 315?
3. Effective Date – Recognizing that ED 01/18 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final ISA. Earlier application would be permitted and encouraged.

Australian Specific

The AUASB asks for constituents views on:

4. Have applicable laws and regulations been appropriately addressed in the proposed standard?
5. Are there any references to relevant laws or regulations that have been omitted?
6. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
7. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed standard? If significant costs are expected, the AUASB would like to understand:
 - (a) Where those costs are likely to occur;
 - (b) The estimated extent of costs, in percentage terms; and
 - (c) Whether expected costs outweigh the benefits to the users of audit services?
8. What, if any, implementation guidance auditors would like the AUASB to issue in conjunction with the release of ASA 315 (specific questions/examples would be helpful).

¹ Conforming amendments to ASA 200, paragraph A42 will be presented with the conforming amendments to ASA 540.

9. Are there any other significant public interest matters that constituents wish to raise?

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

AUTHORITY STATEMENT

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

Conformity with International Standards on Auditing

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

AUDITING STANDARD ASA 2018-1

Amendments to Australian Auditing Standards

Application

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

Operative Date

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

Introduction

Scope of this Auditing Standard

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

Objective

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

Definition

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

Amendments to Auditing Standards

Amendments to ASA 200

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

The Australian Auditing Standards contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The Australian Auditing Standards require that the auditor exercise professional judgement and maintain professional scepticism throughout the planning and performance of the audit and, among other things:

- Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, the applicable financial reporting framework and including the entity's system of internal control.
- Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
- Form an opinion on the financial report based on conclusions drawn from the audit evidence obtained.

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

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

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

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

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

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

Inherent risk is influenced by the characteristics of events or conditions that affect the susceptibility to misstatement of an higher for some assertions about a and related classes of transactions, account balances, or and disclosures than for others, before consideration of controls (i.e. inherent risk factors). Depending on the extent to which the assertion is subject to, or affected by, such inherent risk factors, the level of inherent risk varies along the spectrum of inherent risk. The auditor determines significant classes of transactions, account balances and disclosures, and their relevant assertions, as part of the process of identifying and assessing the risks of material misstatement. For example, ~~it may be higher for complex calculations or for accounts balances~~ consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty may be identified as significant account balances, and the auditor's assessment of inherent risk for the related risks at the assertion level may be higher because of the high estimation uncertainty. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more

susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterised by a large number of business failures.

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

Control risk is a function of the effectiveness of the design, implementation and maintenance of ~~internal~~ controls by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation of the entity's financial report. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial report, because of the inherent limitations of ~~internal~~ controls. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. The Australian Auditing Standards provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures to be performed.¹⁸

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

Risks of material misstatement are assessed at the assertion level in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence.*

* See ASA 330, paragraph 6

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

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

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

For purposes of specifying additional considerations to audits of smaller entities, a “smaller entity” refers to an entity which typically possesses qualitative characteristics such as:

- (a) ...
- (b) One or more of the following:
 - (i) Straightforward or uncomplicated transactions;
 - (ii) Simple record-keeping;
 - (iii) Few lines of business and few products within business lines;
 - (iv) Simpler systems of ~~Few~~ internal controls;
 - (v) Few levels of management with responsibility for a broad range of controls; or
 - (vi) Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.

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

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

Amendments to ASA 240

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

Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override controls ~~procedures~~ designed to prevent similar frauds by other employees.

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

See ASA 315, paragraph ~~22~~40

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

When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, ~~the applicable financial reporting framework and including~~ the entity’s system of internal control, required by ASA 315⁷, the auditor shall perform the procedures in paragraphs ~~2418–4525~~ to obtain information for use in identifying the risks of material misstatement due to fraud.

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

Unless all of those charged with governance are involved in managing the entity,⁸ the auditor shall obtain an understanding of how those charged with governance exercise oversight of management’s processes for identifying and responding to the risks of fraud in the entity and the ~~internal~~ controls that management has established to mitigate these risks. (Ref: Para. A20-A22)

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

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

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

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

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

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

The auditor shall include the following in the audit documentation¹² ~~of the auditor's understanding of the entity and its environment and of the identification and~~ the assessment of the risks of material misstatement required by ASA 315:¹³

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

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

See ASA 315, paragraph ~~5432~~

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

Maintaining professional scepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and maintenance ~~where~~ when such controls are identified to be controls relevant to the audit. Due to the characteristics of fraud, the auditor's professional scepticism is particularly important when considering the risks of material misstatement due to fraud.

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

See ASA 315, paragraphs ~~186(a) and 3423~~, and ASA 610, *Using the Work of Internal Auditors*.

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

Those charged with governance of an entity oversee the entity's systems for monitoring risk, financial control and compliance with the law. In many circumstances, corporate governance practices are well developed and those charged with governance play an active role in oversight of the entity's assessment of the risks of fraud and ~~of the relevant internal control~~ the controls that address such risks. Since the responsibilities of those charged with governance and management may vary by entity and by the circumstances, it is important that the auditor understands their respective responsibilities to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals.¹⁸

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

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

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

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

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

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

Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in Appendix 1. These illustrative risk factors are classified based on the three conditions that are generally present when fraud exists:

- An incentive or pressure to commit fraud;
- A perceived opportunity to commit fraud; and
- An ability to rationalise the fraudulent action.

Fraud risk factors related to incentives, pressures or opportunities may arise from conditions that create susceptibility to misstatements due to management bias or fraud (which is an inherent risk factor). * Alternatively, fraud risk factors may relate to conditions within the entity's system of internal control that provide opportunity to commit fraud or that may affect management's attitude or ability to rationalise fraudulent actions. Risk factors reflective of an attitude that permits rationalisation of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information through, for example, the required understanding of the entity's control environment. ^ Although the fraud risk factors described in Appendix 1 cover a broad range of situations that may be faced by auditors, they are only examples and other risk factors may exist.

* See ASA 315, paragraph 16(f).

^ See ASA 315, paragraphs 27-28.

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

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

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

Further, the auditor's consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries* is important since automated processes and controls may reduce the risk of inadvertent error but do not overcome the risk that individuals may inappropriately override such automated processes, for example, by changing the amounts being automatically passed to the general ledger or to the financial reporting system. Furthermore, where IT is used to transfer information automatically, there may be little or no visible evidence of such intervention in the information systems.

* See ASA 315, paragraph 39(c).

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

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

- *The identification and assessment of the risks of material misstatement due to fraud – the presence of fraud risk factors and other information obtained during the auditor’s identification and assessment of the risks of material misstatement due to fraud may assist the auditor to identify specific classes of journal entries and other adjustments for testing.*
- *Controls that have been implemented over journal entries and other adjustments – effective controls over the preparation and posting of journal entries and other adjustments may reduce the extent of substantive testing necessary, provided that the auditor has tested the operating effectiveness of the controls.*
- *The entity’s financial reporting process and the nature of evidence that can be obtained – for many entities routine processing of transactions involves a combination of manual and automated ~~steps and procedures~~ controls. Similarly, the processing of journal entries and other adjustments may involve both manual and automated ~~procedures and~~ controls. Where information technology is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.*
- *The characteristics of fraudulent journal entries or other adjustments – inappropriate journal entries or other adjustments often have unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual, or seldom-used accounts, (b) made by individuals who typically do not make journal entries, (c) recorded at the end of the period or as post-closing entries that have little or no explanation or description, (d) made either before or during the preparation of the financial report that do not have account numbers, or (e) containing round numbers or consistent ending numbers.*
- *The nature and complexity of the accounts – inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain significant estimates and period-end adjustments, (c) have been prone to misstatements in the past, (d) have not been reconciled on a timely basis or contain unreconciled differences, (e) contain inter-company transactions, or (f) are otherwise associated with an identified risk of material misstatement due to fraud. In audits of entities that have several locations or components, consideration is given to the need to select journal entries from multiple locations.*
- *Journal entries or other adjustments processed outside the normal course of business – nonstandard journal entries may not be subject to the same level of internal nature and extent of controls as those journal entries used on a recurring basis to record transactions such as monthly sales, purchases and cash disbursements.*

Amendments to ASA 240 Appendix 1

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

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

susceptibility to misstatement due to fraud). Fraud risk factors related to opportunities may also relate to conditions within the entity's system of internal control, such as limitations or deficiencies in the entity's internal control that create such opportunities. Fraud risk factors related to attitudes or rationalisations may arise, in particular, from limitations or deficiencies in the entity's control environment.

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

~~Internal control components are deficient~~ Deficiencies in internal control as a result of the following:

- Inadequate ~~monitoring of controls~~ process to monitor the entity's system of internal control, including automated controls and controls over interim financial reporting (where external reporting is required).
- High turnover rates or employment of staff in accounting, information technology, or the internal audit function that are not effective.
- Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

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

Inadequate ~~internal~~ controls over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- ...
- ...

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

- Disregard for ~~internal~~ controls over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.

Amendments to ASA 240 Appendix 2

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

If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of material misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods or findings to determine that the findings are not unreasonable, or engaging another expert for that purpose.

Amendments to ASA 330

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

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

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

The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level. (Ref: Para. A4–A8; A42-A52)

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

In designing the further audit procedures to be performed, the auditor shall:

- (a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each significant class of transactions, account balance, and disclosure, including:
 - (i) The likelihood and magnitude of material misstatement due to the particular characteristics of the ~~relevant~~ significant class of transactions, account balance, or disclosure (that is, the inherent risk); and
 - (ii) Whether the risk assessment takes account of ~~relevant~~ controls that address the risk of material misstatement (that is, the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and (Ref: Para. A9–A18)
- (b) Obtain more persuasive audit evidence the higher the auditor’s assessment of risk. (Ref: Para. A19)

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

The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls if:

- (a) ...
- (b) ...

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

In designing and performing tests of controls, the auditor shall:

- (a) Perform other audit procedures in combination with enquiry to obtain audit evidence about the operating effectiveness of the controls, including:
 - (i) How the controls were applied at relevant times during the period under audit;
 - (ii) The consistency with which they were applied; and
 - (iii) By whom or by what means they were applied. (Ref: Para. A26-A29a)
- (b) To the extent not already addressed, d~~D~~etermine whether the controls to be tested depend upon other controls (indirect controls), and, if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls. (Ref: Para. A30-A31)

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

In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:

- (a) The effectiveness of other ~~elements~~ components of the entity's system of internal control, including the control environment, the entity's process to monitoring of the system of internal controls, and the entity's risk assessment process;
- (b) ...
44. Existing paragraph 14 is amended to read as follows:
- If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance and reliability of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit. The auditor shall obtain this evidence by performing enquiry combined with observation or inspection, to confirm the understanding of those specific controls, and:
- (a) ...
- (b) ...
45. Existing paragraph 16 is amended to read as follows:
- When evaluating the operating effectiveness of ~~relevant~~ controls upon which the auditor intends to rely, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective. (Ref: Para. A40)
46. Existing paragraph 17 is amended to read as follows:
- If deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific enquiries to understand these matters and their potential consequences, and shall determine whether: (Ref: Para. A41)
- (a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;
- (b) Additional tests of controls are necessary; or
- (c) The ~~potential~~ risks of material misstatement need to be addressed using substantive procedures.
47. Existing paragraph 18 is amended to read as follows:
- Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each ~~material~~ class of transactions, account balance, and disclosure that is quantitatively or qualitatively material. (Ref: Para. A42–A47)
48. Existing paragraph 27 is amended to read as follows:
- If the auditor has not obtained sufficient appropriate audit evidence as to the risk of material misstatement related to a material financial report relevant assertion about a class of transactions, account balance or disclosure, the auditor shall attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or disclaim an opinion on the financial report.

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

Overall responses to address the assessed risks of material misstatement at the financial report level may include:

- Emphasising to the engagement team the need to maintain professional scepticism.
- Assigning more experienced staff or those with special skills or using experts.
- Providing more supervision Changes to the nature, timing and extent of direction and supervision of members of the engagement team and the review of the work performed.
- Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
- Changes to the overall audit strategy as required by ASA 300, or planned audit procedures, and may include changes to:
 - The auditor's determination of performance materiality in accordance with ASA 320.
 - The auditor's plans to tests the operating effectiveness of controls, and the persuasiveness of audit evidence needed to support the planned reliance on the operating effectiveness of the controls, particularly when deficiencies in the control environment or the entity's monitoring activities are identified.
 - The nature, timing and extent of substantive procedures. For example, it may be appropriate to perform substantive procedures at or near the date of the financial report when the risk of material misstatement is assessed as higher.
- Making general changes to the nature, timing or extent of audit procedures, for example: performing substantive procedures at the period end instead of at an interim date; or modifying the nature of audit procedures to obtain more persuasive audit evidence.

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

The auditor's assessment of the identified risks of material misstatement at the assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, the auditor may determine that:

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

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

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

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

inherent risk factors.* The auditor's assessed risks, including the reasons for those assessed risks, may affect both the types of audit procedures to be performed and their combination. For example, when an assessed risk is high, the auditor may confirm the completeness of the terms of a contract with the counterparty, in addition to inspecting the document. Further, certain audit procedures may be more appropriate for some assertions than others. For example, in relation to revenue, tests of controls may be most responsive to the assessed risk of material misstatement of the completeness assertion, whereas substantive procedures may be most responsive to the assessed risk of material misstatement of the occurrence assertion.

* See ASA 315, paragraph 48.

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

The reasons for the assessment given to a risk are relevant in determining the nature of audit procedures. For example, if an assessed risk is lower because of the particular characteristics of a class of transactions without consideration of the related controls, then the auditor may determine that substantive analytical procedures alone provide sufficient appropriate audit evidence. On the other hand, if the assessed risk is lower because of ~~internal~~ the operating effectiveness of controls, and the auditor intends to base the substantive procedures on that low assessment, then the auditor performs tests of those controls, as required by paragraph 8(a). This may be the case, for example, for a class of transactions of reasonably uniform, non-complex characteristics that are routinely processed and controlled by the entity's information system.

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

In the case of smaller entities, there may not be many controls ~~activities~~ that could be identified by the auditor, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform further audit procedures that are primarily substantive procedures. In some rare cases, however, the absence of controls ~~activities~~ or of ~~other~~ components of the system of internal control may make it impossible to obtain sufficient appropriate audit evidence.

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

Tests of controls are performed only on those controls that the auditor has determined are suitably designed to prevent, or detect and correct, a material misstatement in an relevant assertion, and the auditor intends to rely upon those controls. If substantially different controls were used at different times during the period under audit, each is considered separately.

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

In some cases, the auditor may find it impossible to design effective substantive procedures that by themselves provide sufficient appropriate audit evidence at the assertion level.³ This may occur when an entity conducts its business using IT and no documentation of transactions is produced or maintained, other than through the IT system. In such cases, paragraph 8(b) requires the auditor to perform tests of ~~relevant~~ controls that address the risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence.

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

See ASA 315, paragraph ~~5130~~.

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

The nature of the particular control influences the type of procedure required to obtain audit evidence about whether the control was operating effectively. For example, if operating effectiveness is evidenced by documentation, the auditor may decide to inspect it to obtain audit evidence about operating effectiveness. For other controls, however, documentation may not be available or relevant. For example, documentation of operation may not exist for some factors in the control environment, such as assignment of authority and responsibility, or for some types of controls activities, such as ~~automated controls activities performed by a computer~~. In such circumstances, audit evidence about operating effectiveness may be obtained through enquiry in combination with other audit procedures such as observation or the use of CAATs.

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

Because of the inherent consistency of IT processing, it may not be necessary to increase the extent of testing of an automated control. An automated controls can be expected to function consistently unless the ~~program~~ IT application (including the tables, files, or other permanent data used by the ~~program~~ IT application) is changed. Once the auditor determines that an automated control is functioning as intended (which could be done at the time the control is initially implemented or at some other date), the auditor may consider performing tests to determine that the control continues to function effectively. Such tests ~~might~~ may include ~~testing the general IT controls related to the IT application.~~ determining that:

- ~~Changes to the program are not made without being subject to the appropriate program change controls;~~
- ~~The authorised version of the program is used for processing transactions; and~~
- ~~Other relevant general controls are effective.~~

~~Such tests also might include determining that changes to the programs have not been made, as may be the case when the entity uses packaged software applications without modifying or maintaining them. For example, the auditor may inspect the record of the administration of IT security to obtain audit evidence that unauthorised access has not occurred during the period.~~

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

Similarly, the auditor may perform tests of controls that address risks of material misstatement related to the integrity of the entity's data, or the completeness and accuracy of the entity's system-generated reports, or to address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence. These tests of controls may include tests of general IT controls that address the matters in paragraph 10(a). When this is the case, the auditor may not need to perform any further testing to obtain audit evidence about the matters in paragraph 10(a).

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

When the auditor determines that a general IT control is deficient, the auditor may consider the nature of the related risk(s) arising from the use of IT that were identified in accordance with ASA 315* to provide the basis for the design of the auditor's additional procedures to determine whether the underlying controls affected by the deficient general IT control functioned throughout the period. Such procedures may address determining whether:

- The related risk(s) arising from IT has occurred. For example, if users have unauthorised access to an IT application (but cannot access or modify the system logs that track access), the auditor may inspect the system logs to obtain audit evidence that those users did not access the IT application during the period.

- There are any alternate or redundant general IT controls, or any other controls, that address the related risk(s) arising from the use of IT. If so, the auditor may determine such controls to be relevant to the audit (if not already relevant to the audit) and therefore evaluate their design, determine that they have been implemented and perform tests of their operating effectiveness. For example, if a general IT control related to user access is deficient, the entity may have an alternate control whereby IT management reviews end user access reports on a timely basis. Circumstances when an application control may address a risk arising from the use of IT may include when the information that may be affected by the general IT control deficiency can be reconciled to external sources (e.g., a bank statement) or internal sources not affected by the general IT control deficiency (e.g., a separate IT application or data source).

* See ASA 315, paragraph 41.

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

In some circumstances, it may be necessary to obtain audit evidence supporting the effective operation of indirect controls (e.g., general IT controls). As explained in paragraphs A29 to A29b, general IT controls may have been determined to be relevant to the audit in accordance with ASA 315 because of their support of the operating effectiveness of automated controls or due to their support in maintaining the integrity of information used in the entity's financial reporting, including system-generated reports. The requirement in paragraph 10(b) acknowledges that the auditor may have already tested certain indirect controls to address the matters in paragraph 10(a). For example, when the auditor decides to test the effectiveness of a user review of exception reports detailing sales in excess of authorised credit limits, the user review and related follow up is the control that is directly of relevance to the auditor. Controls over the accuracy of the information in the reports (for example, general IT controls) are described as "indirect" controls.

62. Existing paragraph A31 is deleted.

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

Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose, for example, when testing controls over the entity's physical inventory counting at the period end. If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of controls in the entity's process to monitoring of the system of internal controls.

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

In certain circumstances, audit evidence obtained from previous audits may provide audit evidence where the auditor performs audit procedures to establish its continuing relevance and reliability. For example, in performing a previous audit, the auditor may have determined that an automated control was functioning as intended. The auditor may obtain audit evidence to determine whether changes to the automated control have been made that affect its continued effective functioning through, for example, enquiries of management and the inspection of logs to indicate what controls have been changed. Consideration of audit evidence about these changes may support either increasing or decreasing the expected audit evidence to be obtained in the current period about the operating effectiveness of the controls.

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

Changes may affect the relevance and reliability of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance. For example, changes in a system that enable an entity to receive a new report from the system probably do not affect the relevance of audit evidence from a previous audit; however, a change that causes data to be accumulated or calculated differently does affect it.

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

In general, the higher the risk of material misstatement, or the greater the reliance on controls, the shorter the time period elapsed, if any, is likely to be. Factors that may decrease the period for retesting a control, or result in not relying on audit evidence obtained in previous audits at all, include the following:

- A deficient control environment.
- A deficiency in the entity's process to monitoring of the system of internal controls.
- A significant manual element to ~~the relevant~~ controls.
- Personnel changes that significantly affect the application of the control.
- Changing circumstances that indicate the need for changes in the control.
- Deficient general IT controls.

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

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

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

This requirement reflects the facts that: (a) the auditor's assessment of risk is judgemental and so may not identify all risks of material misstatement; and (b) there are inherent limitations to ~~internal~~ controls, including management override.

* See ASA 315, paragraph 52.

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

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

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

The ~~nature~~ assessment of the risk ~~and or the nature of the~~ assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial report amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included.

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

Because the assessment of the risk of material misstatement takes account of ~~internal~~ controls upon which the auditor intends to rely, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk.

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

Performing substantive procedures at an interim date without undertaking additional procedures at a later date increases the risk that the auditor will not detect misstatements that may exist at the period end. This risk increases as the remaining period is lengthened. Factors such as the following may influence whether to perform substantive procedures at an interim date:

- The control environment and other ~~relevant~~ controls.
- The availability at a later date of information necessary for the auditor's procedures.
- The purpose of the substantive procedure.
- The assessed risk of material misstatement.
- The nature of the class of transactions or account balance and related assertions.
- The ability of the auditor to perform appropriate substantive procedures or substantive procedures combined with tests of controls to cover the remaining period in order to reduce the risk that misstatements that may exist at the period end will not be detected.

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

An audit of financial report is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing or extent of other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example:

- The extent of misstatements that the auditor detects by performing substantive procedures may alter the auditor's judgement about the risk assessments and may indicate a significant deficiency in internal control.
- The auditor may become aware of discrepancies in accounting records, or conflicting or missing evidence.
- Analytical procedures performed at the overall review stage of the audit may indicate a previously unrecognised risk of material misstatement.

In such circumstances, the auditor may need to re-evaluate the planned audit procedures, based on the revised consideration of assessed risks of material misstatement ~~for all or some of~~ and the effect on the significant classes of transactions, account balances, or disclosures and related their relevant assertions. ASA 315 contains further guidance on revising the auditor's risk assessment.⁷

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

See ASA 315, paragraph ~~543~~.

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

The auditor's judgement as to what constitutes sufficient appropriate audit evidence is influenced by such factors as the following:

- Significance of the potential misstatement in the assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial report.
- Effectiveness of management's responses and controls to address the risks.
- Experience gained during previous audits with respect to similar potential misstatements.
- Results of audit procedures performed, including whether such audit procedures identified specific instances of fraud or error.
- Source and reliability of the available information.
- Persuasiveness of the audit evidence.
- Understanding of the entity and its environment, the applicable financial reporting framework and including the entity's system of internal control.

Appendix 1

(Ref: Para.)

OTHER CONFORMING AND CONSEQUENTIAL AMENDMENTS

Conforming and consequential amendments to Australian Auditing Standards, other than ASA 200, ASA 240 and ASA 330 have been presented in this Appendix. These changes, in the view of the AUASB, are generally straight forward as they are largely changes to definitions so have been presented in table format for practicality.

Three tables are presented within this appendix. Table 1 shows all other conforming and consequential amendments. Where the other conforming and consequential amendments presented within Table 1 include changes in addition to definition changes, further information is shown within Table 2 or Table 3.

Table 1		
Extant Term in the ASAs	Change Made in Proposed ASA 315	Relevant Paragraph(s) Where Change is Proposed
Changes to Names of Components of the System of Internal Control		
Monitoring of controls (extant ASA 315, para's 22–24)	The entity's process to monitor the system of internal control (ED 01/18, para's 32–34)	<u>ASA 210</u> : ² Para. A18 (refer to Table 2) <u>ASA 402</u> : ³ Para. A33 – last bullet Para. A34
The information system, including the related business processes, relevant to financial reporting, and communication (extant ASA 315, para. 18)	The information system, and communication (ED 01/18, para. 35)	<u>ASA 210</u> : Para. A18 (refer to Table 2)
Other Changes		
Monitoring of controls ⁴ (extant ASA 315, para's 22–24)	Controls within the entity's process to monitor the system of internal control (ED 01/18, para's 32–34)	<u>ASA 402</u> : A39 – first bullet <u>ASA 600</u> : ⁵ Appendix 2, para. 1, 8th bullet (refer to Table 2)
Control activities (extant ASA 315, para. 20)	Controls (ED 01/18, para. 38)	<u>ASA 250</u> : ⁶ Para. A23 <u>ASA 265</u> : Para A3 (2nd and 3rd sentences) (refer to Table 2) <u>ASA 500</u> : Para. A17 <u>ASA 501</u> : ⁷ Para. A4 <u>ASA 550</u> : ⁸ Para. A20 <u>ASA 600</u> : Appendix 2, para. 1 (7th bullet)

² ASA 210 *Agreeing the Terms of Audit Engagements*.

³ ASA 402 *Audit Considerations Relating to an Entity Using a Service Organisation*.

⁴ Where this is used to describe what the entity does, as opposed to the name of the component

⁵ ASA 600 *Special Considerations – Audits of a Group Financial Report*.

⁶ ASA 250 *Consideration of laws and Regulations in an Audit of a Financial Report*

⁷ ASA 501 *Audit Evidence – Specific Considerations for Inventory and Segment Information*

⁸ ASA 550 *Related Parties*

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

Table 1		
Extant Term in the ASAs	Change Made in Proposed ASA 315	Relevant Paragraph(s) Where Change is Proposed
		Appendix 5, Matters that are relevant to the conduct of the work of the component auditor (1st bullet) <u>ASA 610:</u> ⁹ Para. A3 Para. A10
Control activities ¹⁰ (extant ASA 315, para. 20)	Controls in the control activities component (ED 01/18, para. 38)	<u>ASA 265:</u> Para. A3 (first sentence) (refer to Table 2)
Relevant control activities (extant ASA 315, para. 20)	Controls relevant to the audit (ED 01/18, para. 38)	<u>ASA 300:</u> ¹¹ Para. A21
The auditor shall determine whether changes have occurred since the previous audit that may affect its relevance to the current audit. (extant ASA 315, para. 9)	The auditor shall evaluate whether such information remains relevant and reliable as audit evidence for the current audit. (ED 01/18, para. 21)	<u>ASA 500:</u> Para. A1
Internal control (extant ASA 315, para. 4(c))	The system of internal control (ED 01/18, para. 16(l))	<u>ASA 210:</u> Para. A18 (refer to Table 2) <u>ASA 265:</u> Para. 1 (second sentence) Para. 2 (first sentence) <u>ASA 620:</u> ¹² Para. A4 (first bullet)
Internal control relevant to the audit (extant ASA 315, para. 12)	Controls relevant to the audit (ED 01/18, para. 26)	<u>ASA 402:</u> Para 14(b)
Internal control relevant to the audit. (extant ASA 315, para. 12)	System of internal control relevant to financial reporting (ED 01/18, para. 25)	<u>ASA 260:</u> ¹³ Para A13, 3rd bullet <u>ASA 265:</u> Para 2 (first sentence) <u>ASA 402:</u> Para. 1 Para. 7(a) Para. 10 (refer to Table 2)
Extant elements of the auditor's understanding of the 'entity and its environment' Extant ASA 315, para. 11 (refer to Table 3)	Revised elements of the auditor's understanding of the 'entity and its environment' (ED 01/18, para. 23 (refer to Table 3))	All the changes in this section are presented in Table 3 <u>ASA 550:</u> Para. A12 <u>ASA 600:</u> Para. A23 <u>ASA 720:</u> ¹⁴ Para. A31

⁹ ASA 610 Using the Work of Internal Auditors

¹⁰ The proposed change in respect of this reference to 'control activities' is slightly different when compared to the proposed change in the previous row. This is due to the particular construction of the first sentence of ASA 265 paragraph A3; however, the meaning of 'controls' remains the same. Also refer to Table 2.

¹¹ ASA 300 Planning an Audit of a Financial Report

¹² ASA 620 Using the Work of an Auditor's Expert

¹³ ASA 260 Communication with Those Charged with Governance

¹⁴ ASA 720 The Auditor's Responsibilities Relating to Other Information

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

Table 1		
Extant Term in the ASAs	Change Made in Proposed ASA 315	Relevant Paragraph(s) Where Change is Proposed
Understanding the entity and its environment ¹⁵ (extant ASA 315, para. 11)	Understanding the entity and its environment, the applicable financial reporting framework and the system of internal control (ED 01/18, para. 17)	<u>ASA 230:</u> Para. A17 (refer Table 2) <u>ASA 600:</u> Para. 17 <u>ASA 620:</u> Para. A4 (first bullet) <u>ASA 720 (Revised):</u> Para. A31 (refer Table 3)
Require special audit consideration (in context of significant risks) (extant ASA 315, para. 4(e))	<i>Change as appropriate or delete</i> (ED 01/18, para. 16(k) and A10)	All the changes in this section are presented in Table 2 <u>ASA 260:</u> Para. A12 <u>ASA 550:</u> Para. A28 <u>ASA 600:</u> Para. A6 <u>ASA 610:</u> Para. A21 <u>ASA 701:</u> Para. A20
Relevant controls (extant ASA 315, para 13–heading)	Controls relevant to the audit (ED 01/18, para. 26)	<u>ASA 402:</u> Para. 10 (refer Table 2) Para. 12 (c) and (d) Para. A19 Para. A22 (hanging paragraph) Para. A29 Para. A30 (1st and 2nd sentences) Para. A33
Relevant controls (extant ASA 315, para 13–heading)	<i>Change as appropriate</i>	<u>ASA 530:</u> ¹⁶ Appendix 2, factor 1 (refer Table 2) <u>ASA 550:</u> Para. A34 – last sentence (refer Table 2)
Identifying and assessing the risks of material misstatement through understanding the entity and its environment (name of standard)	Identifying and assessing the risks of material misstatement	<u>ASA 210:</u> Footnote 14 <u>ASA 220:</u> ¹⁷ Footnote 13 <u>ASA 230:</u> Footnote 5 Appendix <u>ASA 250:</u> ¹⁸ Footnote 4 <u>ASA 260 (Revised):</u> Footnote 4 <u>ASA 265:</u> Footnote 1

¹⁵ When reference is made to the auditor’s understanding of the entity and its environment, and in the specific context used, are intended to be inclusive of the auditor’s understanding of internal control

¹⁶ ASA 530 Audit Sampling

¹⁷ ASA 220 Quality Control for an Audit of a Financial Report and Other Historical Financial Information

¹⁸ ASA 250 Consideration of Laws and Regulations in an Audit of Financial Statements

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

Table 1		
Extant Term in the ASAs	Change Made in Proposed ASA 315	Relevant Paragraph(s) Where Change is Proposed
		<u>ASA 300:</u> Footnote 4 <u>ASA 320:</u> ¹⁹ Footnote 3 <u>ASA 402:</u> Footnote 1 <u>ASA 500:</u> Footnote 1
Identifying and assessing the risks of material misstatement through understanding the entity and its environment (name of standard)	Identifying and assessing the risks of material misstatement	<u>ASA 505:</u> ²⁰ Footnote 14 <u>ASA 510:</u> ²¹ Footnote 4 <u>ASA 520:</u> ²² Footnote 1 <u>ASA 550:</u> Footnote 1 <u>ASA 570:</u> ²³ Footnote 3 <u>ASA 600:</u> Footnote 7 <u>ASA 610:</u> Footnote 1 <u>ASA 700:</u> Footnote 35 <u>ASA 701:</u> Footnote 5 <u>ASA 720:</u> Footnote 11 <u>ASA 800:</u> Footnote 5
Relevant assertion (this is now a defined term)	<i>As appropriate</i>	Refer to Table 2: ASA 265 para. A8
<i>Aspects of the entity's</i> information system (ASA 315, para. 18)	Alignment to the requirements to understanding the information system. (ED 01/18, para. 35)	<u>ASA 402:</u> Para. 3 (refer to Table 2)

¹⁹ ASA 320 Materiality in Planning and Performing an Audit

²⁰ ASA 505 External Confirmations

²¹ ASA 510 Initial Audit Engagements—Opening Balances

²² ASA 520 Analytical Procedures

²³ ASA 570 *Going Concern*

Table 2	
Description of components of the system of internal control	
1.	<p>ASA 210, para. A18</p> <p>It is for management to determine what internal control is necessary to enable the preparation of the financial report. The term “internal control” encompasses a wide range of activities within components of the system of internal control that may be described as the control environment; the entity’s risk assessment process; <u>the entity’s process to monitor the system of internal control</u>, the information system, including the related business processes relevant to financial reporting, and communication; and control activities; and monitoring of controls. This division, however, does not necessarily reflect how a particular entity may design, implement and maintain its internal control, or how it may classify any particular component.¹⁵ An entity’s internal control (in particular, its accounting books and records, or accounting systems) will reflect the needs of management, the complexity of the business, the nature of the risks to which the entity is subject, and relevant laws or regulation.</p> <p>ASA 210, footnote 15</p> <p><u>See ASA 315, paragraph A9959 and Appendix 34</u></p>
Controls within the entity’s process to monitor the system of internal control	
2.	<p>ASA 600, Appendix 2, paragraph 1 (8th bullet)</p> <p><i>Group-Wide Controls</i></p> <p>1. Group-wide controls may include a combination of the following:</p> <ul style="list-style-type: none"> • Regular meetings between group and component management to discuss business developments and to review performance. • ... • <u>Controls within the group’s process to monitor</u> Monitoring the system of internal controls, including activities of the internal audit function and self-assessment programs.
Control activities	
3.	<p>ASA 265, para. A3</p> <p>While the concepts underlying <u>controls in the control activities component</u> in smaller entities are likely to be similar to those in larger entities, the formality with which they operate will vary. Further, smaller entities may find that certain types of controls activities are not necessary because of controls applied by management. For example, management’s sole authority for granting credit to customers and approving significant purchases can provide effective control over important account balances and transactions, lessening or removing the need for more detailed controls activities.</p>

Table 2	
'Controls relevant to the audit', and the 'system of internal control'	
4.	<p>ASA 402, para. 10</p> <p>When obtaining an understanding of <u>the system of</u> internal control relevant to the audit <u>financial reporting</u> in accordance with ASA 315,⁴ the user auditor shall evaluate the design and implementation of relevant <u>controls relevant to the audit</u> at the user entity that relate to the services provided by the service organisation, including those that are applied to the transactions processed by the service organisation. (Ref: Para. A12–A14)</p> <p>ASA 402, footnote 4</p> <p>See ASA 315, paragraph 2512.</p>
Describing aspects of the entity and its environment in extant ASA 315:	
5.	<p>ASA 230, para. A17</p> <p>When preparing audit documentation, the auditor of a smaller entity may also find it helpful and efficient to record various aspects of the audit together in a single document, with cross-references to supporting working papers as appropriate. Examples of matters that may be documented together in the audit of a smaller entity include the understanding of the entity and its <u>environment, the applicable financial reporting framework, and the entity's system of</u> internal control, the overall audit strategy and audit plan, materiality determined in accordance with ASA 320,⁹ assessed risks, significant matters noted during the audit, and conclusions reached.</p>
References to risks that 'require special audit consideration'	
6.	<p>ASA 260, para. A12</p> <p>Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they <u>were determined to be significant risks</u> require special audit consideration. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process.</p>
7.	<p>ASA 550, para. A28</p> <p><i>Sharing Related Party Information with the Engagement Team</i> (Ref: Para. 17)</p> <p>Relevant related party information that may be shared among the engagement team members includes, for example:</p> <ul style="list-style-type: none"> • The identity of the entity's related parties. • The nature of the related party relationships and transactions. • Significant or complex related party relationships or transactions that may <u>be determined to be significant risks</u> require special audit consideration, in particular transactions in which management or those charged with governance are financially involved.

Table 2

8. ASA 600, para. A6

The group engagement team may also identify a component as likely to include significant risks of material misstatement of the group financial report due to its specific nature or circumstances. (that is, risks that require special audit consideration¹⁴). For example, a component could be responsible for foreign exchange trading and thus expose the group to a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group.

ASA 600, footnote 14

See ASA 315, paragraphs 27–29.

9. ASA 610, para. A21

As explained in ASA 315,²² significant risks ~~require special audit consideration~~ are risks assessed close to the upper end of the spectrum of inherent risk and therefore the external auditor's ability to use the work of the internal audit function in relation to significant risks will be restricted to procedures that involve limited judgement. In addition, where the risks of material misstatement is other than low, the use of the work of the internal audit function alone is unlikely to reduce audit risk to an acceptably low level and eliminate the need for the external auditor to perform some tests directly.

ASA 610, footnote 22

See ASA 315 (as amended), paragraph 4(k)(e).

10. ASA 701, para. A20

ASA 315 defines a significant risk as an identified ~~and assessed~~ risk of material misstatement:

- For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which one or a combination of the inherent risk factors affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should that misstatement occur; or
- That is to be treated as a significant risk in accordance with the requirement of other ASAs,⁷ that, in the auditor's judgement, requires special audit consideration. Areas of significant management judgement and significant unusual transactions may often be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention.

ASA 701 footnote *

See ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*, paragraph 27 and ISA 550 *Related Parties*, paragraph 18.

Extant references to relevant controls

11. ASA 530

Appendix 2, factor 1

An increase in the extent to which the auditor's risk assessment takes into account ~~relevant~~ controls that address the risk of material misstatement.

Table 2

12. ASA 550, para. A34

Depending upon the results of the auditor’s risk assessment procedures, the auditor may consider it appropriate to obtain audit evidence without testing the entity’s controls over related party relationships and transactions. In some circumstances, however, it may not be possible to obtain sufficient appropriate audit evidence from substantive audit procedures alone in relation to the risks of material misstatement associated with related party relationships and transactions. For example, where intra-group transactions between the entity and its components are numerous and a significant amount of information regarding these transactions is initiated, recorded, processed or reported electronically in an integrated system, the auditor may determine that it is not possible to design effective substantive audit procedures that by themselves would reduce the risks of material misstatement associated with these transactions to an acceptably low level. In such a case, in meeting the ASA 330 requirement to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls,²⁶ the auditor is required to test the entity’s controls over the completeness and accuracy of the recording of the related party relationships and transactions.

Extant references to ‘relevant assertion’

13. ASA 265, para. A8

A deficiency in internal control on its own may not be sufficiently important to constitute a significant deficiency. However, a combination of deficiencies affecting the same account balance or disclosure, ~~relevant~~ assertion, or component of internal control may increase the risks of misstatement to such an extent as to give rise to a significant deficiency.

Alignment to the requirements to understanding the information system

14. ASA 402, para. 3

Services provided by a service organisation are relevant to the audit of a user entity’s financial report when those services, and the controls over them, are part of the user entity’s information system, including related business processes, relevant to financial reporting. Although most controls at the service organisation are likely to relate to financial reporting, there may be other controls that may also be relevant to the audit, such as controls over the safeguarding of assets. A service organisation’s services are part of a user entity’s information system, including related business processes, relevant to financial reporting if these services affect any of the following:

- (a) How information relating to significant classes of transactions, account balances and disclosures flows through the user entity’s information system, whether manually or using IT, and whether obtained from within or outside the general ledger and subsidiary ledgers. The classes of transactions in the user entity’s operations that are significant to the user entity’s financial report; This includes when the service organisation’s services affect how:
 - (i) ~~(b) The procedures, within both information technology (IT) and manual systems, by which the user entity’s transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial report; Transactions of the user entity are initiated, and how information about them is recorded, processed, corrected as necessary, and incorporated in the general ledger and reported in the financial report; and~~
 - (ii) Information about events and conditions, other than transactions, is captured, processed and disclosed by the user entity in the financial report.

Table 2

- (b) ~~(e) The related accounting records, either in electronic or manual form, supporting information and specific accounts in the user entity's financial report and other supporting records relating to the flows of information in paragraph 3(a) that are used to initiate, record, process and report the user entity's transactions; this includes the correction of incorrect information and how information is transferred to the general ledger;~~
- (d) ~~How the user entity's information system captures events and conditions, other than transactions, that are significant to the financial report;~~
- (c) ~~(e) The financial reporting process used to prepare the user entity's financial report from the records described in paragraph 3(b), including as it relates to disclosures and to accounting estimates relating to significant classes of transactions, account balances and disclosures accounting estimates and disclosures; and~~
- (d) The entity's IT environment relevant to (a) to (c) above.
- (f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

Table 3

Describing aspects of the entity and its environment in extant ASA 315 (*changes to the description of the entity and its environment are described below*):

1. ASA 550, para. A12

However, where the framework does not establish related party requirements, the entity may not have such information systems in place. Under such circumstances, it is possible that management may not be aware of the existence of all related parties. Nevertheless, the requirement to make the enquiries specified by paragraph 13 still applies because management may be aware of parties that meet the related party definition set out in this ASA. In such a case, however, the auditor's enquiries regarding the identity of the entity's related parties are likely to form part of the auditor's risk assessment procedures and related activities performed in accordance with ASA 315 to obtain information regarding the entity's organisational structure, ownership, governance and business model:

- The entity's ownership and governance structures;
- The types of investments that the entity is making and plans to make; and
- The way the entity is structured and how it is financed.

In the particular case of common control relationships, as management is more likely to be aware of such relationships if they have economic significance to the entity, the auditor's enquiries are likely to be more effective if they are focused on whether parties with which the entity engages in significant transactions, or shares resources to a significant degree, are related parties.

2. ASA 600, para. A23

Matters about Which the Group Engagement Team Obtains an Understanding (Ref: Para. 17)

ASA 315 contains guidance on matters the auditor may consider when obtaining an understanding of the entity and its environment, including:

- The entity's organisational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT;
- Relevant industry, regulatory, and other external factors that affect the entity;
- The relevant measurement used, internally and externally, to assess and review of the entity's financial performance; and
- The ~~including~~ applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and ¹⁷

Appendix 2 of this ASA contains guidance on matters specific to a group including the consolidation process.

ASA 600, footnote 17

See ASA 315, paragraphs ~~A17-A41~~ A49-A88.

Table 3

3. ASA 720, para. A31

The auditor’s knowledge obtained in the audit includes the auditor’s understanding of the entity and its environment, the applicable financial reporting framework, and including the entity’s system of internal control, obtained in accordance with ASA 315.¹¹ ASA 315 sets out the auditor’s required understanding, which includes such matters as obtaining an understanding of:

- (a) The entity’s organisational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT;
- (b) ~~The~~ ~~relevant~~ industry, regulatory, and other external factors;
 The nature of the entity;
 The entity’s selection and application of accounting policies;
 The entity’s objectives and strategies;
- (c) The relevant measures used, internally and externally, to assess measurement and review of the entity’s financial performance; ~~and~~
- (d) The applicable financial reporting framework; and
- (e) The entity’s system of internal control.

ASA 720, footnote 11

See ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*, paragraphs ~~2311–2512~~.

Proposed amendments to the auditor’s required understanding of ‘the entity and its environment’

The following describes extant elements of the auditor’s understanding of the ‘entity and its environment’ – ASA 315 paragraph 11:

The Entity and Its Environment

The auditor shall obtain an understanding of the following:

- (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework. (Ref: Para. A25–A30)
- (b) The nature of the entity, including:
 - (i) its operations;
 - (ii) its ownership and governance structures;
 - (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
 - (iv) the way that the entity is structured and how it is financed, to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial report. (Ref: Para. A31–A35)

Table 3

- (c) The entity’s selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity’s accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry. (Ref: Para. A36)
- (d) The entity’s objectives and strategies, and those related business risks that may result in risks of material misstatement. (Ref: Para. A37-A43)
- (e) The measurement and review of the entity’s financial performance. (Ref: Para. A44-A49)

The following describes the revised elements of the auditor’s understanding of the ‘entity and environment’ – ED 01/18 paragraph 23:

The auditor shall perform risk assessment procedures to obtain an understanding of the entity and its environment and the applicable financial reporting framework. In doing so, the auditor shall obtain an understanding of the following matters to provide an appropriate basis for understanding the classes of transactions, account balances and disclosures to be expected in the entity’s financial report:

- (a) The entity and its environment, including:
 - (i) The entity’s organisational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT; (Ref: Para A49-A63)
 - (ii) Relevant industry, regulatory and other external factors; and (Ref: Para. A64-A69)
 - (iii) The relevant measures used, internally and externally, to assess the entity’s financial performance. (Ref: Para. A70-A78)
- (b) The applicable financial reporting framework, including: (Ref: Para.A79-A82)
 - (i) How it applies in the context of the nature and circumstances of the entity and its environment, including how events or conditions are subject to, or affected by, the inherent risk factors; and (Ref: Para.A83-A88)
 - (ii) The entity’s accounting policies and any changes thereto, including the reasons for any changes to the entity’s accounting policies.

Changes will also be made to the AUASB Glossary as needed.