

2 November 2018

Dan Montgomery  
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International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, 10017  
USA

Dear Dan,

***Proposed ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement (ED-315)***

Thank you for the opportunity to comment on this Exposure Draft. We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB) to the specific questions raised in the Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*, (ED-315) in the attachment.

The External Reporting Board (XRB) is a Crown Entity responsible for developing and issuing accounting and auditing and assurance standards in New Zealand. The XRB's outcome goal is to contribute to the creation of dynamic and trusted markets through the establishment of an accounting and assurance framework that engenders confidence in New Zealand financial reporting, assists entities to compete internationally and enhances entities' accountability to stakeholders. The NZAuASB has been delegated responsibility by the XRB for developing and issuing auditing and assurance standards, including ethical standards for assurance practitioners.

**Overall comments**

The NZAuASB is very supportive of the IAASB's initiative to enhance and update ISA 315 (Revised) for the public interest matters identified in paragraphs 6 to 28 of the Explanatory Memorandum of ED-315. Except for the issues discussed below, the NZAuASB believes that ED-315 is successful in appropriately addressing these matters.

A recurring message the NZAuASB received from its constituency is that the length of ED-315 is a barrier to its readability and understandability and therefore its effective implementation. The potential implementation challenges are seen to be disproportionately more difficult for practitioners from smaller and medium size practices that do not have the same level of technical resources at their disposal compared to larger firms with central technical offices.

The NZAuASB considers that the IAASB webinars dealing with questions and answers were extremely helpful in this regard and recommends developing non- authoritative guidance in the form of FAQs and practical examples to assist auditors with the implementation of the standard. We further believe that certain matters included in ED-315 can either be excluded or be transferred to such guidance material to shorten ED-315. We have included a list of such matters in appendix 1 to the Schedule of Responses to the IAASB's Specific Questions.

Furthermore, the NZAuASB is of the view that the scalability of the ISAs remains an elusive objective and we do not consider that the proposed approach significantly improves the scalability of ISA 315 (Revised) compared to the extant standard.

Overall the NZAuASB believes that addressing scalability of the ISAs needs to be considered holistically across the suite of auditing standards and a fresh drafting approach may be needed to achieve scalability. The NZAuASB appreciates that the IAASB has commenced activities and a project in this regard. We support the IAASB's efforts to address scalability within individual standards until the fruition of such activities.

In formulating this response, the NZAuASB sought input from New Zealand constituents. Roundtables were held in both Auckland and Wellington. We were also fortunate to have Fiona Campbell, Task Force Chair, present two webinars to NZAuASB and AUASB constituents. Fiona was also present at one of our roundtables to answer questions which was very helpful to the participants.

Should you have any queries concerning our submission please contact me at the address details provided below or Sylvia van Dyk ([sylvia.vandyk@xrb.govt.nz](mailto:sylvia.vandyk@xrb.govt.nz)).

Yours sincerely,

**Robert Buchanan**

**Chairman**

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## Submission of the New Zealand Auditing and Assurance Standards Board

### *Proposed ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement*

#### I Schedule of Responses to the IAASB's Specific Questions

##### *Overall Questions*

1. **Has ED-315 been appropriately restructured, clarified and modernized in order to promote a more consistent and robust process for the identification and assessment of the risks of material misstatement. In particular:**
  - (a) **Do the proposed changes help with the understandability of the risk identification and assessment process? Are the flowcharts helpful in understanding the flow of the standard (i.e., how the requirements interact and how they are iterative in nature)?**

Yes. The NZAuASB believes that the restructure and re-arrangements of the requirements and application material in the proposed standard help with the understandability of the risk identification and assessment process.

The NZAuASB appreciates that risk identification and assessment is a complex and iterative process which is not easy to present in a linear standard form. The three flowcharts are useful to enhance a better high-level understanding of the standard and the flow of the risk assessment.

Notwithstanding the above, the NZAuASB considers that the significant increased length of the proposed standard may be a barrier to understanding it. Including the flowcharts as part of the standard would be helpful in this regard.

- (b) **Will the revisions promote a more robust process for the identification and assessment of the risks of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6-28?**

Yes. The NZAuASB agrees that the proposed standard is likely to promote a more robust process for the identification of risks of material misstatement.

The restructure and re-arrangements of the requirements and application material is a significant improvement over the extant ISA 315.

- Introduction of the inherent risk factors is another useful addition that will be helpful to auditors in how to identify and assess inherent risk.
- The proposed approach in addressing the use of automated tools and techniques and data analytics in application and other explanatory material section of the standard is very timely and relevant, given the wide range of techniques being used which are constantly evolving.
- Revisions in relation to Information Technology (IT) and how an auditor should consider IT as part of the risk assessment is particularly appropriate.

The NZAuASB also believes that the proposed standard is overall successful in addressing the public interest issues outlined in paragraphs 6-28 of ED-315, other than scalability, which we discuss further in our response to question 2.

**(c) Are the new introductory paragraphs helpful?**

Yes. The introductory paragraphs provide an overview of the standard and help the reader to better understand the principles underlying the proposed standard. However, it may be useful to clearly describe the status of these paragraphs, and if they are authoritative. The NZAuASB believes that this may need further clarification.

**2. Are the requirements and application material of ED-315 sufficiently scalable, including the ability to apply ED-315 to the audits of entities with a wide range of sizes, complexities and circumstances?**

While the NZAuASB believes that the requirements of the proposed standard are relevant to all audit engagements regardless of their size or complexity, the proposed standard does not significantly improve the scalability of application of these requirements compared to the extant standard. Consistent with other ISAs, the application and other explanatory material of the proposed standard is drafted for a complex, large and high-risk audit engagement. Auditors of small and less complex entities need to go through all the application and explanatory material to then be able to scale down.

Notwithstanding the above, the NZAuASB appreciates the IAASB's efforts to improve the scalability of ED-315 over the extant standard. For example, under the circumstances described in paragraph A167 of ED-315, the only controls relevant to the audit of a small and less complex entity would be controls over journal entries. This guidance is likely to assist the auditors of smaller and less complex entities with scaling back the standard. The NZAuASB suggests that paragraph A90 of ED-315, which explains that the extent and nature of required understanding of each component of internal controls relevant to financial reporting depends on matters such as size and complexity of the entity, is included after paragraph 26 of ED-315. The NZAuASB believes that including this paragraph in the requirement section of the proposed standard can help with the scalability of ED-315.

Finally, the NZAuASB does not believe that the new approach adopted in ED-315<sup>1</sup> makes a difference to scalability. On the other hand, the length of ED-315 (more than twice of the length of extant ISA 315) is likely to adversely affect how the standard is read and understood by the auditors of smaller and less complex entities.

**3. Do respondents agree with the approach taken to enhancing ED-315 in relation to automated tools and techniques, including data analytics, through the use of examples to illustrate how these are used in an audit (see Appendix 1 for references to the relevant paragraphs in ED-315)? Are there other areas within ED-315 where further guidance is needed in relation to automated tools and techniques, and what is the nature of the necessary guidance?**

Yes. the proposed approach is appropriate. The NZAuASB believes that the reasoning in paragraphs 20 to 23 of the Explanatory Memorandum soundly supports the adopted approach in ED-315. The NZAuASB has not identified any areas where additional guidance is needed in relation to automated tools and techniques.

**4. Do the proposals sufficiently support the appropriate exercise of professional scepticism throughout the risk identification and assessment process? Do you support the proposed change for the auditor to 'obtain appropriate sufficient audit evidence' through the performance of risk assessment procedures to provide the basis for identification and assessment of the risks of material misstatement, and do you believe that this clarification will further encourage professional scepticism?**

The NZAuASB does not support the proposed change in paragraph 17 of ED-315 for the auditor to

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<sup>1</sup> I.e. to include the guidance for small and less complex audits within the application material paragraphs instead of under a separate heading (as in the extant ISA315)

'obtain appropriate sufficient audit evidence' through the performance of risk assessment procedures to provide the basis for identification and assessment of the risks of material misstatement. As stated in paragraph 2 of ED-315, the overall objective of the auditor in conducting an audit of the financial statements includes obtaining sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. This objective is consistent with the definition of audit evidence as "Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information."<sup>2</sup>

Requiring auditors to obtain appropriate sufficient audit evidence as the basis for their risk identification process is inconsistent with the existing definition of audit evidence and why it is obtained. The NZAuASB believes that appropriate documentation of the required understanding in paragraph 17 more accurately describes what can be reasonably expected from an auditor in relation to performing a risk assessment process. Consequently, the NZAuASB suggests deleting the words as indicated:

"The auditor shall design and perform risk assessment procedures to obtain an understanding of:

- The entity and its environment
- The applicable financial reporting framework
- The entity's system of internal control

~~To obtain sufficient appropriate audit evidence~~ as the basis for the identification and assessment of the risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion."

#### *Specific Questions*

**5. Do the proposals made relating to the auditor's understanding of the entity's system of internal control assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks of material misstatement? Specifically:**

**(a) Have the requirements related to the auditor's understanding of each component of the entity's system of internal control been appropriately enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?**

The NZAuASB agrees that obtaining an understanding of the system of internal controls is a fundamental part of the auditor's risk assessment. Paragraph A200 of ED-315 provides a reasonable explanation why understanding the system of internal controls is required in an audit even if there is no expectation of testing the operating effectiveness of controls (i.e. control risk defaulted to maximum).

Notwithstanding the above, during the NZAuASB's consultations with its constituency, a recurring question was why understanding all the components of the entity's system of internal control (to the extent required by ED-315) is required when a primarily substantive approach to the audit is planned. For example, when an auditor does not rely on internal controls (control risk defaulted to a maximum), the outcome of such an understanding will have no impact on the auditor's assessment of internal control (risk of internal controls cannot be more than maximum).

The NZAuASB believes that it may be helpful to further clarify that understanding the system of internal control is relevant to the auditor's identification and assessment of inherent risk as well as

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<sup>2</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with International Auditing Standards*, paragraph 13(b).

control risk. The NZAuASB supports non-authoritative guidance including examples to clarify this issue. The IAASB webinar dealing with questions and answers were extremely helpful in this regard, and it may be worthwhile publishing a FAQ to assist auditors with the implementation of the standard.

- (b) Have the requirements related to the auditor's identification of controls relevant to the audit been appropriately enhanced and clarified? Is it clear how controls relevant to the audit are identified, particularly for audits of smaller and less complex entities?**

In response to the first part of the question the answer is yes. Paragraph 39 of ED-315 provides a clear and easy to understand list of controls that are relevant to the audit and clarifies what is expected from auditors in relation to the relevant controls.

The NZAuASB's response to the second part of the question is a tentative yes due to some concerns in relation to the required procedures to understand the entity's use of IT in the information system. The NZAuASB's concerns about this are further discussed in the response to question 5(c) below.

- (c) Do you support the introduction of the new IT-related concepts and definitions? Are the enhanced requirements and application material related to the auditor's understanding of the IT environment, the identification of the risks arising from IT and the identification of general IT controls sufficient to support the auditor's consideration of the effects of the entity's use of IT on the identification and assessment of the risks of material misstatement?**

The NZAuASB strongly supports the new IT-related concepts and definitions. The NZAuASB welcomes the proposed clarifications and enhancements as well as the additional guidance included in ED-315 about risks arising from an entity's use of IT in its information system.

Notwithstanding the above, the NZAuASB is concerned that the application material corresponding to the requirements included in paragraphs 35(d) and 40 of ED-315 may be difficult to understand and interpret for the auditors of smaller and less complex entities.

Paragraph A144 explains that the objective of performing the required procedures in paragraph 35(d) is to identify and assess risks arising from the use of IT. Paragraph A145 provides examples of such risks. Finally, paragraph A149 explains that obtaining the required understanding in the audits of smaller and less complex entities can be easily accomplished. This paragraph describes matters an auditor may need to consider in such circumstances.

However, the application material does not explain how the recommended work described in Paragraph A149 will relate to the identification of risks arising from the use of IT as discussed in paragraphs A144 and A145 (e.g. whether well-established, reputable and reliable software is immune to unauthorized access or improper changes to data). It also remains unclear whether the auditor of a small and less complex entity that meets the circumstances described in para 149 is required to consider matters included in paragraphs A147 and A148 of ED-315.

Finally, the NZAuASB is concerned that the described circumstances in paragraph A149 for a small and less complex entity is not typical for small and less complex entities in the developed countries. Even micro entities are likely to use electronic banking solutions, software for managing human resources (including payroll processing and employment record keeping), computerised sale and ordering systems and/or inventory management systems in addition to a commercial accounting software. Consequently, the included example in ED-315 for a small and less complex entity may be over simplified and may cause some auditors to underestimate the importance of IT in their circumstances.

The NZAuASB recommends that instead of contrasting a very simple IT environment (where IT is

effectively not applicable) to a sophisticated IT environment, the application material considers a spectrum for how the use of IT can influence the information systems (and controls) underlying the financial statements.

**6. Will the proposed enhanced framework for the identification and assessment of the risks of material misstatement result in a more robust risk assessment? Specifically:**

**(a) Do you support separate assessments of inherent and control risk at the assertion level, and are the revised requirements and guidance appropriate to support the separate assessments?**

The NZAuASB supports the separate assessment and considers the proposed requirements and application material to be appropriate. To further clarify the separation between inherent and control risk assessment, the NZAuASB suggests the following changes to paragraph 4 of ED-315.

“The required understanding of the entity and the environment, the applicable financial reporting framework, and the system of internal controls form the basis for the auditor’s identification of risks of material misstatement. The identification of the inherent risk component of risks of material misstatement at the assertion level is performed before consideration of any controls. The auditor does so based on a preliminary assessment of inherent risk that involve by identifying those risks for which a preliminary inherent risk assessment indicates there is a reasonable possibility of misstatement.

**(b) Do you support the introduction of the concepts and definitions of ‘inherent risk factors’ to help identify risks of material misstatement and assess inherent risk? Is there sufficient guidance to explain how these risk factors are used in the auditor’s risk assessment process?**

The NZAuASB considers emphasising factors including complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or fraud is helpful and will drive more consistency as to the types of and reasons for identification of risks. The NZAuASB believes that there is sufficient guidance in ED-315 about the inherent risk factors.

The NZAuASB further believes that the magnitude of an account balance, class of transactions or disclosure (including potential omissions and understatements) may be another inherent risk factor to be included in ED-315. This simply reflects the fact that a misstatement related to a larger account balance, class of transactions or disclosure is more likely to be a material misstatement. Including size as an inherent risk factor is also likely to help with determining whether a stand-back requirement is required in both ED-315 and ISA 330 (further discussed in the NZAuASB’s response to the question 8 below).

**(c) In your view, will the introduction of the ‘spectrum of inherent risk’ (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks?**

The NZAuASB supports the introduction of the concept and acknowledges the “spectrum of inherent risk” is a practical way to identify and then assess inherent risk. The NZAuASB also believes the concepts of likelihood of occurrence and magnitude of possible misstatements are useful, i.e. in planning the audit effort the auditor will take both of these into account. Feedback from NZAuASB’s constituents indicates the proposed standard caters for different firm methodologies and will assist with the consistent application of ED-315 in practice.

**(d) Do you support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and their relevant assertions?**

**Is there sufficient guidance to explain how they are determined (i.e., an assertion is relevant when there is a reasonable possibility of occurrence of a misstatement that is material with respect to the assertion), and how they assist the auditor in identifying where risks of material misstatement exist?**

The NZAuASB agrees that defining significant classes of transactions, account balances and disclosures is useful and may help to clarify the scope of the auditor's understanding of the information system and the scope for the auditor's responses to the assessed risks of material misstatement.

The NZAuASB however has concerns in relation to the definition of 'relevant assertions'. Paragraph 16(h) defines a relevant assertion as follows.

"an assertion is relevant to a class of transactions, account balance or disclosure when the nature or circumstances of that item are such that there is a reasonable possibility of occurrence of a misstatement with respect to that assertion that is material, individually or in combination with other misstatements. There is such possibility when the likelihood of a material misstatement is more than remote. The determination of whether an assertion is a relevant assertion is made before consideration of controls".

The NZAuASB considers that the current drafting could be clarified further as these two terms may be seen as different, which may be confusing. If the two terms are seen as equivalent, the NZAuASB questions the need to use both terms.

- (e) Do you support the revised definition, and related material, on the determination of 'significant risks'? What are your views on the matters presented in paragraph 57 of the Explanatory Memorandum relating to how significant risks are determined on the spectrum of inherent risk?**

The NZAuASB supports the revised definition, and related material, on the determination of 'significant risks' noting that supporting the assessment of the likelihood of occurrence of risk of material misstatement can be particularly difficult for auditors in practice. The NZAuASB is therefore of the view that more guidance on how the auditor should assess the probability to support this assessment would be useful.

In relation to matters presented in paragraph 57 of the Explanatory memorandum the NZAuASB's views are as follows.

The proposal discussed in the paragraph 57 of the Explanatory memorandum requires the auditor to focus on risks that may have a high magnitude but a low likelihood and also on risks that have a high likelihood but a low magnitude. The NZAuASB does not agree that all of these risks would necessarily achieve the objective of the upper end of the spectrum of risk, rather would broaden the identification of significant risks much further along than at the "upper end" of the spectrum.

The feedback that the NZAuASB has received on this matter indicates potential for inconsistent application of this requirement in practice.

While the NZAuASB supports a focus on the nature of the risk rather than the response to the risk it considers that auditors would best focus on risks for which there is a high likelihood AND high magnitude. The NZAuASB also believes further application material in ED-315 and/or additional non-authoritative guidance may be needed to illustrate the practical application of this matter.

**7. Do you support the additional guidance in relation to the auditor’s assessment of risks of material misstatement at the financial statements level, including the determination about how, and the degree to which, such risks may affect the assessment of risks at the assertion level?**

The NZAuASB supports the additional guidance on the auditor’s assessment of risk of material misstatement at the financial statements level. The feedback received from the NZAuASB’s constituents indicates that additional examples of risks of material misstatement at the financial statements level (in addition to the commonly used fraud risk) is welcome. Similarly, additional examples to illustrate the auditor’s response to the identified risks of material misstatement at the financial statements level is likely to enhance the understandability of ED-315 in this regard.

**8. What are your views about the proposed stand-back requirement in paragraph 52 of ED-315 and the revisions made to paragraph 18 of ISA 330 and its supporting application material? Should either or both requirements be retained? Why or why not?**

The NZAuASB considers that the addition of a stand-back requirement is useful and will promote a more robust framework to ensure that all relevant assertions are addressed in the audit.

The NZAuASB has received mixed feedback in relation to whether the stand-back requirement in paragraph 18 of ISA 330 is needed.

Those in favor of removing the stand-back requirement in ISA 330 are of the view that with a comprehensive and enhanced risk assessment and a stand-back requirement in ED-315, the stand-back requirement in ISA 330 is redundant. A robust risk assessment process concluded with a stand-back requirement that prompts the auditor of an entity to explicitly consider if they have omitted any risk of material misstatement for all material classes of transactions, account balances or disclosures is sufficient.

Others believe that since the stand-back requirement in ISA 330 requires auditors to perform substantive audit procedures over material classes of transactions, account balances or disclosure, even when the auditor has not identified any related risks of material misstatement, it is not equivalent to the stand-back requirement in paragraph 52 of ED-315 (which prompts auditors to perform procedures if there is a risk of material misstatement). They believe that removing the stand-back requirement in ISA 330 will adversely impact audit quality as the auditor’s risk assessment may fail to appropriately identify all risks of material misstatements. They believe the stand-back requirement in ISA 330 acts as a counter measure to that possibility.

The NZAuASB is of the view that should the size of account balances, classes of transactions or disclosures be included as an ‘inherent risk factor’ (as suggested in the NZAuASB response to question 6(b) above) in ED-315, there will be a stronger case for removing the stand-back requirement of ISA 330. This is because considering size as an inherent risk factor is likely to substantially address the concern that material account balances, classes of transactions or disclosure may be left out.

*Conforming and Consequential Amendments*

**9. With respect to the proposed conforming and consequential amendments to:**

**(a) ISA 200 and ISA 240, are these appropriate to reflect the corresponding changes made to ISA 315 (Revised)?**

The NZAuASB considers the proposed conforming amendments appropriate.

**(b) ISA 300, are the changes appropriate in light of the enhancements that have been made in ISA 315 (Revised), in particular as a consequence of the introduction of the concept of general IT controls relevant to the audit?**

The NZAuASB considers the proposed conforming amendments appropriate.

**(c) The other ISAs as presented in Appendix 2, are these appropriate and complete?**

The NZAuASB considers the proposed conforming amendments appropriate and complete.

**(d) ISA 540 (Revised) and related conforming amendments (as presented in the Supplement to this exposure draft), are these appropriate and complete.**

The NZAuASB considers the proposed conforming amendments appropriate and complete.

**10. Do you support the proposed revisions to paragraph 18 of ISA 330 to apply to classes of transactions, account balances or disclosures that are 'qualitatively or quantitatively material' to align with the scope of the proposed stand-back in ED-315?**

Yes. The NZAuASB supports this proposed revision.

*Request for General Comments*

**11. (a) Translations**

**(b) Effective Date**

The NZAuASB has no comment on potential translation issues.

The NZAuASB supports an effective date of approximately 18 months after approval of the final ISA with early application permitted and encouraged. We believe that 18 months allows sufficient time for national due process.

## **Appendix 1 to Submission of the New Zealand Auditing and Assurance Standards Board**

This appendix includes examples of how ED-315 can be shortened to improve its understandability. The NZAuASB has identified the following categories for material that can be taken out of ED-315:

- Category 1: application and other explanatory material that are repetitive (i.e. either repeats the requirement or covers application material that included in introductory or explanatory paragraphs).
- Category 2: Explanatory material with an educational nature that can be included in a non-authoritative guidance material instead.
- Category 3: Long terms that can be abbreviated.

Category 1: application and other explanatory material that are repetitive (i.e. either repeats the requirement or covers application material that included in introductory or explanatory paragraphs)

| Paragraph number |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | The NZAuASB's comments                                                                                                                                                 |
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| A21              | <del>Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. Information may also be obtained by the auditor through inquiries of the internal audit function, if the entity has such a function, and others within the entity.</del>                                                                                                                                                                                                                                                                                                                                                                                                                                  | Repeats the requirement in Para. 18(a).                                                                                                                                |
| A25              | <del>If an entity has an internal audit function, inquiries of the appropriate individuals within the function may provide information that is useful to the auditor in obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, and in identifying and assessing risks of material misstatement at the financial statement and assertion levels. In performing its work, the internal audit function is likely to have obtained insight into the entity's operations and business risks, ....</del>                                                                                                                                                   | The deleted part of Para. A25 repeats the requirement in Para. 18(a) and can be taken out without changing the understandability of Para. A25                          |
| A38              | <del>The engagement partner may have performed other engagements for the entity and may thereby have obtained knowledge relevant to the audit, including about the entity and its environment. Such engagements may include agreed-upon procedures engagements (e.g., agreed-upon procedures relating to an entity's debt covenant compliance) or other audit or assurance engagements (e.g., audits of special purpose financial statements or reviews of interim financial information).</del>                                                                                                                                                                                                                                                      | The deleted sentence repeats the requirement in paragraph 20.                                                                                                          |
| A40              | <del>The auditor is required to determine whether information obtained in prior periods remains relevant and reliable, if the auditor intends to use that information for the purposes of the current audit. This is because changes in the entity's system of internal control, for example, may affect the relevance and reliability of information obtained in the prior period. In evaluating whether such information remains relevant and reliable for the current audit, the auditor may consider whether changes have occurred that may affect the relevance or reliability of such information. For example, the auditor may make inquiries and perform other appropriate audit procedures, such as walk-throughs of relevant systems.</del> | The first deleted sentence repeats the requirement in Para. 21. The second deleted sentence is educational material and can be included in non-authoritative guidance. |
| A41              | <del>Paragraph 22 requires the engagement partner and other key engagement team members to discuss the application of the applicable financial reporting framework in the context of the nature and circumstances of the entity and its environment, and the susceptibility of the entity's financial statements to material misstatement. When the engagement is carried out by a single individual (such as a sole practitioner) i.e., where an engagement team discussion would not be possible, consideration of the matters referred to in paragraphs A42 and A43 nonetheless may assist the auditor in identifying where there may be risks of material misstatement.</del>                                                                     | The deleted part repeats requirements included in Para. 22                                                                                                             |
| A47              | <del>The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, establishes a frame of reference within which the auditor identifies and assesses risks of material misstatement, and plans and performs audit procedures. Specifically, †The auditor applies professional judgment in determining whether the understanding required by paragraph 23 is sufficient to provide an appropriate basis for the auditor to understand the classes of transactions, account balances and disclosures to be expected in the</del>                                                                                                                                                                     | The first deleted sentence repeats the explanatory material in Para. A14.                                                                                              |

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|      | <p>entity's financial statements. This understanding assists the auditor in identifying areas in the financial statements where material misstatements may be more likely to arise and assists the auditor in exercising professional skepticism throughout the audit. The nature and extent of the understanding required will likely depend on the nature, size and complexity of the entity.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <p>The second deleted sentence is educational and can be taken out without undermining the meaning of this paragraph.</p> |
| A90  | <p>The auditor is required to perform risk assessment procedures to obtain an understanding of each component of internal control relevant to financial reporting. Paragraphs 27-38 address the matters the auditor is required to understand in relation to the components of the system of internal control. The nature, timing, and extent of risk assessment procedures that the auditor performs to obtain this the understanding of the matters addressed in paragraphs 27-38 are matters of the auditor's professional judgment and are based on the auditor's determination as to what will provide sufficient and appropriate audit evidence for the auditor's identification and assessment of risks of material misstatement. Accordingly, the nature, timing and extent of procedures to understand the entity's system of internal control will vary from entity to entity, and may depend on matters such as:</p> <ul style="list-style-type: none"> <li>• The size and complexity of the entity, including its IT environment.</li> <li>• Previous experience with the entity.</li> <li>• The nature of each component<sup>110</sup> of the entity's system of internal control.</li> <li>• The nature and form of the entity's documentation, including as it relates to specific controls.</li> </ul> | <p>The deleted sentences repeat the requirement. The words in red are suggested additions.</p>                            |
| A121 | <p>When the auditor determines, in accordance with paragraph 31(b), that a control deficiency exists related to the entity's risk assessment process, the auditor is required to determine, in accordance with paragraph 43, whether any such deficiency constitutes a significant control deficiency. Whether the absence of an appropriate risk assessment process represents a significant control deficiency is a matter of the auditor's professional judgment. Circumstances that may indicate a significant control deficiency exists include matters such as:</p> <ul style="list-style-type: none"> <li>• The absence of a risk assessment process when such a process would ordinarily be expected to have been established; or</li> <li>• Evidence of an ineffective risk assessment process, which may be the case when the process has failed to identify a risk of material misstatement when it would be expected the risk assessment process would have identified the risk.</li> </ul>                                                                                                                                                                                                                                                                                                                | <p>The deleted sentence is not needed.</p>                                                                                |
| A129 | <p>Much of the information used in monitoring may be produced by the entity's information system. If management assumes that information used for monitoring is accurate without having a basis for that assumption, errors that may exist in the information could potentially</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <p>The first two sentences of this paragraph are educational</p>                                                          |

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|      | <p>lead management to incorrect conclusions from its monitoring activities. Accordingly, an understanding of:</p> <ul style="list-style-type: none"> <li>• The sources of the information related to the entity's monitoring activities; and</li> <li>• The basis upon which management considers the information to be sufficiently reliable for the purpose of the monitoring activities</li> </ul> <p>is required to provide a basis for the auditor's understanding of the entity's process to monitor the system of internal control.</p>                                                                                                                                                             | <p>material. The remaining part is a repetition of the requirement included in Para. 33.</p>                                                                                                                                                                                          |
| A168 | <p>The auditor determines whether there are any risks of material misstatement at the assertion level for which it is not possible or practicable to obtain sufficient appropriate audit evidence through substantive procedures alone as described in paragraph 51. The auditor is required, in accordance with ISA 330.115 to design and perform tests of relevant controls that address such risks of material misstatement when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. As a result, when such controls exist that address these risks, they are relevant to the audit.</p>                                                          | <p>This paragraph repeats the application guidance in Para. A239.</p> <p>This paragraph can be deleted without undermining the understandability of the standard. It may be more useful to refer the requirement in Paragraph 39(a) to the requirement described in paragraph 51.</p> |
| A169 | <p>The auditor determines whether any assessed risks of material misstatement at the assertion level are significant risks in accordance with paragraph 49. Significant risks are those that exist close to the upper end of the spectrum of inherent risk and therefore are those risks of material misstatement that require the most persuasive audit evidence in accordance with ISA 330.116 Paragraph 39 requires that the auditor identify controls that address significant risks to be controls relevant to the audit. The risk assessment procedures performed to understand these controls in accordance with paragraph 42 contribute to the audit evidence related to the significant risk.</p> | <p>This paragraph repeats the application guidance in Para. A229.</p> <p>This paragraph can be deleted without undermining the understandability of the standard. It may be more useful to refer the requirement in Paragraph 39(b) to the requirement described in paragraph 49.</p> |
| A207 | <p>The required understanding of the entity and the environment, the applicable financial reporting framework, and the system of internal control forms the basis for the auditor's identification of risks of material misstatement. Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole, and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure</p>                                                                                                                         | <p>This paragraph includes explanatory material already included in the introductory paragraph and requirements</p>                                                                                                                                                                   |

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|      | <p>level. Rather, they represent circumstances that may pervasively increase the risks of material misstatement at the assertion level.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | <p>specified in Para. 45. There is also application guidance about pervasive risks of material misstatement in paragraphs A215 to A219.</p>                                                                                            |
| A208 | <p><del>Risks of material misstatements that do not relate pervasively to the financial statements are risks of material misstatement at the assertion level. The identification of risks of material misstatement at the assertion level is performed before consideration of any controls. The auditor does so based on a preliminary assessment of inherent risk that involves identifying those risks for which there is a reasonable possibility of material misstatement. The assertions to which such risks of material misstatement relate are relevant assertions, and the classes of transactions, account balances and disclosures to which the relevant assertions relate are significant classes of transactions, account balances and disclosures.</del></p> | <p>This paragraph includes explanatory material already included in the introductory paragraph and requirements specified in Para. 45. There is also application guidance about RMM at assertion level in paragraphs A221 to A227.</p> |

Category 2) Explanatory material with an educational nature that can be included in a non-authoritative guidance material instead.

| Paragraph number |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | The NZAuASB comment |
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| A42              | <p>The discussion among the engagement team about the susceptibility of the entity's financial statements to material misstatement:</p> <ul style="list-style-type: none"> <li>• Provides an opportunity for more experienced engagement team members, including the engagement partner, to share their insights based on their knowledge of the entity. Sharing information contributes to an enhanced understanding by all engagement team members.</li> <li>• Allows the engagement team members to exchange information about the business risks to which the entity is subject, how the inherent risk factors may affect the classes of transactions , account balances and disclosures , and about how and where the financial statements might be susceptible to material misstatement due to fraud or error.</li> <li>• Assists the engagement team members to gain a better understanding of the potential for material misstatement of the financial statements in the specific areas assigned to them , and to understand how the results of the audit procedures that they perform may affect other aspects of the audit including the decisions about the nature, timing and extent of further audit procedures . In particular , the discussion assists engagement team members in further considering contradictory information based on each member's own understanding of the nature and circumstances of the entity.</li> <li>• Provides a basis upon which engagement team members communicate and share new information obtained throughout the audit that may affect the assessment of risks of material misstatement or the audit procedures performed to address these risks.</li> </ul> <p>ISA 240 requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud , including how fraud may occur. 105</p> |                     |
| A44              | <p>In addition to the intended benefits of the engagement team discussion included in paragraph A42, the engagement team may also have an opportunity to exercise professional skepticism while performing risk assessment procedures, such as through identifying and discussing contradictory information obtained in performing those procedures , as well as in considering whether there are indicators of possible management bias (both intentional and unintentional). Professional skepticism is necessary for the critical assessment of audit evidence, and a robust and open engagement team discussion, including for recurring audits, may lead to improved identification and assessment of the risks of material misstatement. Another outcome from the discussion may be that the auditor identifies specific areas of the audit</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                     |

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|  | for which exercising professional skepticism may be particularly important, which may in turn drive the consideration of those engagement team members who are appropriately skilled to be involved in the performance of audit procedures related to those areas. |  |
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Use of abbreviation for long terms

| Full term                                                                                                                                 | Could be shorten to                                    | Used in paragraphs                                            |
|-------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------|---------------------------------------------------------------|
| Understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control | The required understanding (e.g. as used in Para. A16) | Para. A12<br>Para. A14<br>Para. A20<br>Para. A25<br>Para. A47 |