NZ AUDITING AND ASSURANCE STANDARDS BOARD

Board Meeting Agenda

12 February 2019

9.20 am to 5.15pm

XRB Offices, Level 7, 50 Manners Street, Wellington

Est. Time	Item	Topic	Objective		Page
A: NON-PUBLIC SESSION					
B: PUBLIC SESSION					
11:15 am	**4**	**ISA (NZ) 315 and conforming amendments**			
	4.1	Board meeting summary paper	Note	Paper	
	4.2	ISA (NZ) 315	Approve	Paper	
	4.3	Conforming Amendments	Approve	Paper	
	4.4	Signing memorandum	Approve	Paper	
11.45 am	**5**	**NAS and Fees**			
	5.1	Board meeting summary paper	Note	Paper	
12.15	**6**	**ISA (NZ) 560, Subsequent Events**			
	6.1	Board meeting summary paper	Note	Paper	
	6.2	Amending standard ISA (NZ) 560	Approve	Paper	
	6.3	Signing memorandum	Approve	Paper	
12.45 pm	*Lunch*				
1.30 pm	**7**	**Primary financial statements**			
	7.1	Board meeting summary paper	Note	Paper	
	7.2	Feedback to NZASB	Discuss	Verbal	
2.10 pm	**8**	**Mandate change**			
	8.1	Board meeting summary paper	Note	Paper	
	8.2	XRB Au1 *Application of Auditing and Assurance Standards*	Consider	Paper	
	8.3	EG Au 1 *Overview of Auditing and Assurance Standards*	Consider	Paper	
	8.4	EG Au2 Overview of the Auditing and Assurance Standard Setting Process	Consider	Paper	
2.40 pm	**9**	**Amendments to PES 1 (for Part 2)**			
	9.1	Board meeting summary paper	Note	Paper	
	9.2	Issues paper	Consider	Paper	
	9.3	Draft ITC and ED	Approve	Paper	
	9.4	NZ Contextual changes	Note	Paper	
3: 15pm	*Afternoon tea*				
3.30 pm	**10**	**IESBA ED EQR Objectivity**			
	10.1	Board meeting summary paper	Note	Paper	

Est. Time	Item	Topic	Objective		Page
	10.2	Exposure Draft – EQR Objectivity	Consider	Paper	
4.00pm	**11**	**Part 4B amendments to Code**			
	11.1	Board meeting summary paper	Note	Paper	
	11.2	Amending standard	Approve	Paper	
	11.3	Amending Part 4B marked	Note	Paper	
	11.4	Signing memorandum	Approve	Paper	
4.30 pm	**12**	**Environmental Scanning**			
	12.1	International monitoring update	Paper	Note	
	12.2	Domestic monitoring update	Paper	Note	
C: NON-PUBLIC SESSION					

Next meeting: 9 April 2020, Wellington

NZ AUDITING AND ASSURANCE STANDARDS BOARD

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	4.1
Meeting date:	12 February 2020
Subject:	ISA (NZ) 315 (Revised 2019)
Date:	31 January 2020
Prepared by:	Peyman Momenan

X **Action Required**	☐ **For Information Purposes Only**

Agenda Item Objectives

1. The objective of this agenda item is for the Board to:

   - APPROVE Conforming Amendments to ISAs (NZ) and Other Pronouncements resulted from approval of ISA (NZ) 315 (Revised 2019).
   - APPROVE the signing memorandum.

Background

2. The Board approved ISA (NZ) 315 (Revised 2019) in December 2019, subject to any final amendments to be made by the IAASB. Approval of the conforming amendments was deferred to this meeting.

3. The Board also considered the signing memorandum and requested the following changes to be made to the memo.

   - The fact that the revised standard was contested by some of the IAASB members (both on content and the need for re-exposure) should be included in the memo.
   - A section should be added to address the XRB's statutory obligation to consult the Privacy Commissioner in respect of any privacy considerations.

   Approval of the signing memo was also deferred to this meeting.

Matters to Consider

4. We have updated ISA (NZ) 315 (Revised 2019) to include the last editorial amendments made in issuing the international standard. We have also included hyperlinks within the New Zealand standard, to enable navigation between the requirements and application material.

5. The Board is asked to CONSIDER and APPROVE Conforming Amendments to ISAs (NZ) and Other Pronouncements and APPROVE the signing memorandum.

6. The Conforming Amendments to ISAs (NZ) and Other Pronouncements, at agenda item 4.3, will be gazetted once approved by the Board, along with the ISA (NZ) 315 (Revised 2019), at agenda item 4.2.

7. In preparing the Conforming Amendments to ISAs (NZ) and Other Pronouncements, the staff noted some additional changes to other ISAs that are not identified by the IAASB. These additional changes mainly relate to references to the name of ISA 315 that has not been updated, and cross references that require updating. These instances were brought to the attention of the IAASB staff who confirmed these changes should have been made. The IAASB will make these changes separately within the Handbook (due to be published in June 2020) to inform others of them. We have included these items in the New Zealand conforming amendments to be approved by the NZAuASB. We will monitor these amendments to ensure that we align going forward but consider that we have already identified the majority of any missing amendments.

Material Presented

Agenda item 4.1	Board meeting summary paper
Agenda item 4.2	Draft ISA (NZ) 315 (Revised)
Agenda item 4.3	Draft Conforming Amendments to ISAs (NZ) and Other Pronouncements (clean for approval)
Agenda item 4.4	Draft signing memorandum (for approval)

INTERNATIONAL STANDARD ON AUDITING (NEW ZEALAND) 315 (Revised 2019)

Identifying and Assessing the Risks of Material Misstatement (ISA (NZ) 315 (Revised 2019))

This Standard was issued on ?? by the New Zealand Auditing and Assurance Standards Board of the External Reporting Board pursuant to section 12(b) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on ??.

An auditor that is required to apply this Standard is required to apply it for audits of financial statements for periods beginning on or after 15 December 2021. However, early adoption is permitted.

In finalising this Standard, the New Zealand Auditing and Assurance Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Standard has been issued as a result of International Standard on Auditing 315 being revised.

This Standard, when applied, supersedes International Standard on Auditing (New Zealand) (ISA (NZ)) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment.*

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ISBN 978-0-947505-57-8

INTERNATIONAL STANDARD ON AUDITING (NEW ZEALAND) 315 (Revised 2019)

IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT

Issued by the New Zealand Auditing and Assurance Standards Board

CONTENTS

International Standard on Auditing (New Zealand) (ISA (NZ)) 315 (Revised 2019)**, "Identifying and Assessing the Risks of Material Misstatement" should be read in conjunction with** ISA (NZ) **200, "Overall Objectives of the** Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealan**d)."**

History of Amendments

Table of pronouncements – ISA (NZ) 315 (Revised 2019) *Identifying and Assessing the Risks of Material Misstatement*

This table lists the pronouncements establishing and amending ISA (NZ) 315 (Revised 2019).

Pronouncements	**Date approved**	**Effective date**
International Standard on Auditing (New Zealand) 315 (Revised 2019)	December 2019	Effective for audits of financial statements for periods beginning on or after 15 December 2021.

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements.

Key Concepts in this ISA (NZ)

2. ISA (NZ) 200 deals with the overall objectives of the auditor in conducting an audit of the financial statements,[1] including to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.[2] Audit risk is a function of the risks of material misstatement and detection risk.[3] ISA (NZ) 200 explains that the risks of material misstatement may exist at two levels:[4] the overall financial statement level; and the assertion level for classes of transactions, account balances and disclosures.

3. ISA (NZ) 200 requires the auditor to exercise professional judgement in planning and performing an audit, and to plan and perform an audit with professional scepticism recognising that circumstances may exist that cause the financial statements to be materially misstated.[5]

4. Risks at the financial statement level relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of material misstatement at the assertion level consist of two components, inherent and control risk:

   - Inherent risk is described as the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

   - Control risk is described as 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 system of internal control.

5. ISA (NZ) 200 explains that 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.[6] For the identified risks of material misstatement at the assertion level, a separate assessment of inherent risk and

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[1] ISA (NZ) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*

[2] ISA (NZ) 200, paragraph 17

[3] ISA (NZ) 200, paragraph 13(c)

[4] ISA (NZ) 200, paragraph A36

[5] ISA (NZ) 200, paragraphs 15–16

[6] ISA (NZ) 200, paragraph A43a and ISA (NZ) 330, *The Auditor's Responses to Assessed Risks*, paragraph 6

control risk is required by this ISA (NZ). As explained in ISA (NZ) 200, inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others. The degree to which inherent risk varies is referred to in this ISA (NZ) as the 'spectrum of inherent risk.'

6. Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud. Although both are addressed by this ISA (NZ), the significance of fraud is such that further requirements and guidance are included in ISA (NZ) 240[7] in relation to risk assessment procedures and related activities to obtain information that is used to identify, assess and respond to the risks of material misstatement due to fraud.

7. The auditor's risk identification and assessment process is iterative and dynamic. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control are interdependent with concepts within the requirements to identify and assess the risks of material misstatement. In obtaining the understanding required by this ISA (NZ), initial expectations of risks may be developed, which may be further refined as the auditor progresses through the risk identification and assessment process. In addition, this ISA (NZ) and ISA (NZ) 330 require the auditor to revise the risk assessments, and modify further overall responses and further audit procedures, based on audit evidence obtained from performing further audit procedures in accordance with ISA (NZ) 330, or if new information is obtained.

8. ISA (NZ) 330 requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.[8] ISA (NZ) 330 further explains that the auditor's assessment of the risks of material misstatement at the financial statement level, and the auditor's overall responses, is affected by the auditor's understanding of the control environment. ISA (NZ) 330 also requires the auditor to 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.[9]

Scalability

9. ISA (NZ) 200 states that some ISAs (NZ) include scalability considerations which illustrate the application of the requirements to all entities regardless of whether their nature and circumstances are less complex or more complex.[10] This ISA (NZ) is intended for audits of all entities, regardless of size or complexity and the application material therefore incorporates specific considerations specific to both less and more complex entities, where appropriate. While the size of an entity may be an indicator of its complexity, some smaller entities may be complex and some larger entities may be less complex.

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7 ISA (NZ) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

8 ISA (NZ) 330, paragraph 5

9 ISA (NZ) 330, paragraph 6

10 ISA (NZ) 200, paragraph A65a

Effective Date

10. This ISA (NZ) is effective for audits of financial statements for periods beginning on or after 15 December 2021.

Objective

11. The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

Definitions

12. For purposes of the ISAs (NZ), the following terms have the meanings attributed below:

    (a) *Assertions* – Representations, explicit or otherwise, with respect to the recognition, measurement, presentation and disclosure of information in the financial statements which are inherent in management representing that the financial statements are prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing and responding to the risks of material misstatement. (Ref: Para. A1)

    (b) *Business risk* – A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.

    (c) *Controls* – Policies or procedures that an entity establishes to achieve the control objectives of management or those charged with governance. In this context: (Ref: Para. A2–A5)

        (i) Policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.

        (ii) Procedures are actions to implement policies.

    (d) *General information technology (IT) controls* – Controls over the entity's IT processes that support the continued proper operation of the IT environment, including the continued effective functioning of information processing controls and the integrity of information (i.e., the completeness, accuracy and validity of information) in the entity's information system. Also see the definition of IT environment.

    (e) *Information processing controls* – Controls relating to the processing of information in IT applications or manual information processes in the entity's information system that directly address risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information). (Ref: Para. A6)

(f) *Inherent risk factors* – Characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors[11] insofar as they affect inherent risk. (Ref: Para. A7–A8)

(g) *IT environment* – The IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this ISA (NZ):

(i) An IT application is a program or a set of programs that is used in the initiation, processing, recording and reporting of transactions or information. IT applications include data warehouses and report writers.

(ii) The IT infrastructure comprises the network, operating systems, and databases and their related hardware and software.

(iii) The IT processes are the entity's processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations.

(h) *Relevant assertions* – An assertion about a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement. The determination of whether an assertion is a relevant assertion is made before consideration of any related controls (i.e., the inherent risk). (Ref: Para. A9)

(i) *Risks arising from the use of IT* – Susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information) in the entity's information system, due to ineffective design or operation of controls in the entity's IT processes (see IT environment).

(j) *Risk assessment procedures* – The audit procedures designed and performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

(k) *Significant class of transactions, account balance or disclosure* – A class of transactions, account balance or disclosure for which there is one or more relevant assertions.

(l) *Significant risk* – An identified risk of material misstatement: (Ref: Para. A10)

(i) 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 inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur; or

[11] ISA (NZ) 240, paragraphs A24–A27

(ii) That is to be treated as a significant risk in accordance with the requirements of other ISAs (NZ).[12]

(m) *System of internal control* – The system designed, implemented and maintained by those charged with governance, management and other personnel, to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. For the purposes of the ISAs (NZ), the system of internal control consists of five inter-related components:

(i) Control environment;

(ii) The entity's risk assessment process;

(iii) The entity's process to monitor the system of internal control;

(iv) The information system and communication; and

(v) Control activities.

Requirements

Risk Assessment Procedures and Related Activities

13. The auditor shall design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for: (Ref: Para. A11–A18)

(a) The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels; and

(b) The design of further audit procedures in accordance with ISA (NZ) 330.

The auditor shall design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. (Ref: Para. A14)

14. The risk assessment procedures shall include the following: (Ref: Para. A19–A21)

(a) Enquiries of management and of other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists). (Ref: Para. A22–A26)

(b) Analytical procedures. (Ref: Para. A27–A31)

(c) Observation and inspection. (Ref: Para. A32–A36)

Information from Other Sources

15. In obtaining audit evidence in accordance with paragraph 13, the auditor shall consider information from: (Ref: Para. A37–A38)

(a) The auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement; and

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[12] ISA (NZ) 240, paragraph 27 and ISA (NZ) 550, *Related Parties*, paragraph 18

(b) When applicable, other engagements performed by the engagement partner for the entity.

16. When the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor shall evaluate whether such information remains relevant and reliable as audit evidence for the current audit. (Ref: Para. A39–A41)

Engagement Team Discussion

17. The engagement partner and other key engagement team members shall discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement. (Ref: Para. A42–A47)

18. When there are engagement team members not involved in the engagement team discussion, the engagement partner shall determine which matters are to be communicated to those members.

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control (Ref: Para. A48–A49)

Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework (Ref: Para. A50–A55)

19. The auditor shall perform risk assessment procedures to obtain an understanding of:
    (a) The following aspects of the entity and its environment:
        (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. A56–A67)
        (ii) Industry, regulatory and other external factors; (Ref: Para. A68–A73) and
        (iii) The measures used, internally and externally, to assess the entity's financial performance; (Ref: Para. A74–A81)
    (b) The applicable financial reporting framework, and the entity's accounting policies and the reasons for any changes thereto; (Ref: Para. A82–A84) and
    (c) How inherent risk factors affect susceptibility of assertions to misstatement and the degree to which they do so, in the preparation of the financial statements in accordance with the applicable financial reporting framework, based on the understanding obtained in (a) and (b). (Ref: Para. A85–A89)

20. The auditor shall evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework.

Understanding the Components of the Entity's System of Internal Control (Ref: Para. A90 – A95)

Control Environment, the Entity's Risk Assessment Process and the Entity's Process to Monitor the System of Internal Control (Ref: Para. A96–A98)

Control environment

<table>
<tr><td colspan="2">21. The auditor shall obtain an understanding of the control environment relevant to the preparation of the financial statements, through performing risk assessment procedures, by: (Ref: Para. A99–A100)</td></tr>
<tr><td>(a) Understanding the set of controls, processes and structures that address: (Ref: Para. A101–A102)
(i) How management's oversight responsibilities are carried out, such as the entity's culture and management's commitment to integrity and ethical values;
(ii) When those charged with governance are separate from management, the independence of, and oversight over the entity's system of internal control by, those charged with governance;
(iii) The entity's assignment of authority and responsibility;
(iv) How the entity attracts, develops, and retains competent individuals; and
(v) How the entity holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control;</td><td>and
(b) Evaluating whether: (Ref: Para. A103–A108)
(i) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behaviour;
(ii) The control environment provides an appropriate foundation for the other components of the entity's system of internal control considering the nature and complexity of the entity; and
(iii) Control deficiencies identified in the control environment undermine the other components of the entity's system of internal control.</td></tr>
</table>

The entity's risk assessment process

<table>
<tr><td colspan="2">22. The auditor shall obtain an understanding of the entity's risk assessment process relevant to the preparation of the financial statements, through performing risk assessment procedures, by:</td></tr>
<tr><td>(a) Understanding the entity's process for: (Ref: Para. A109–A110)
(i) Identifying business risks relevant to financial reporting objectives; (Ref: Para. A62)
(ii) Assessing the significance of those risks, including the likelihood of their occurrence; and
(iii) Addressing those risks;</td><td>and
(b) Evaluating whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity. (Ref: Para. A111–A113)</td></tr>
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23. If the auditor identifies risks of material misstatement that management failed to identify, the auditor shall:
    (a) Determine whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process and, if so, obtain an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement; and
    (b) Consider the implications for the auditor's evaluation in paragraph 22(b).

The entity's process to monitor the system of internal control

<table>
<tr><td colspan="2">24. The auditor shall obtain an understanding of the entity's process for monitoring the system of internal control relevant to the preparation of the financial statements, through performing risk assessment procedures, by: (Ref: Para. A114–A115)</td></tr>
<tr><td>(a) Understanding those aspects of the entity's process that address:
(i) Ongoing and separate evaluations for monitoring the effectiveness of controls, and the identification and remediation of control deficiencies identified; (Ref: Para. A116–A117) and
(ii) The entity's internal audit function, if any, including its nature, responsibilities and activities; (Ref: Para. A118)
(b) Understanding the sources of the information used in the entity's process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose; (Ref: Para. A119–A120)</td><td>and
(c) Evaluating whether the entity's process for monitoring the system of internal control is appropriate to the entity's circumstances considering the nature and complexity of the entity. (Ref: Para. A121–A122)</td></tr>
</table>

Information System and Communication, and Control Activities (Ref: Para. A123–A130)

The information system and communication

<table>
<tr><td colspan="2">25. The auditor shall obtain an understanding of the entity's information system and communication relevant to the preparation of the financial statements, through performing risk assessment procedures, by: (Ref: Para. A131)</td></tr>
<tr><td>(a) Understanding the entity's information processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances and disclosures: (Ref: Para. A132–A143)</td><td>and
(c) Evaluating whether the entity's information system and communication appropriately support the preparation of the entity's financial statements in accordance with the applicable</td></tr>
</table>

(i) How information flows through the entity's information system, including how: a. Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, incorporated in the general ledger and reported in the financial statements; and b. Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial statements; (ii) The accounting records, specific accounts in the financial statements and other supporting records relating to the flows of information in the information system; (iii) The financial reporting process used to prepare the entity's financial statements, including disclosures; and (iv) The entity's resources, including the IT environment, relevant to (a)(i) to (a)(iii) above; (b) Understanding how the entity communicates significant matters that support the preparation of the financial statements and related reporting responsibilities in the information system and other components of the system of internal control: (Ref: Para. A144–A145) (i) Between people within the entity, including how financial reporting roles and responsibilities are communicated; (ii) Between management and those charged with governance; and (iii) With external parties, such as those with regulatory authorities;	financial reporting framework. (Ref: Para. A146)

Control activities

26. The auditor shall obtain an understanding of the control activities component, through performing risk assessment procedures, by: (Ref: Para. A147–A157)	
(a) Identifying controls that address risks of material misstatement at the assertion level in the control activities component as follows: (i) Controls that address a risk that is determined to be a significant risk; (Ref: Para. A158–A159) (ii) Controls over journal entries, including non-standard journal entries used to record non-	and (d) For each control identified in (a) or (c)(ii): (Ref: Para. A175–A181) (i) Evaluating whether the control is designed effectively to address the

recurring, unusual transactions or adjustments; (Ref: Para. A160–A161) (iii) Controls for which the auditor plans to test operating effectiveness in determining the nature, timing and extent of substantive testing, which shall include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; and (Ref: Para. A162–A164) (iv) Other controls that the auditor considers are appropriate to enable the auditor to meet the objectives of paragraph 13 with respect to risks at the assertion level, based on the auditor's professional judgement; (Ref: Para. A165) (b) Based on controls identified in (a), identifying the IT applications and the other aspects of the entity's IT environment that are subject to risks arising from the use of IT; (Ref: Para. A166–A172) (c) For such IT applications and other aspects of the IT environment identified in (b), identifying: (Ref: Para. A173–A174) (i) The related risks arising from the use of IT; and (ii) The entity's general IT controls that address such risks;	risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls; and (ii) Determining whether the control has been implemented by performing procedures in addition to enquiry of the entity's personnel.

Control Deficiencies Within the Entity's System of Internal Control

27. Based on the auditor's evaluation of each of the components of the entity's system of internal control, the auditor shall determine whether one or more control deficiencies have been identified. (Ref: Para. A182–A183)

Identifying and Assessing the Risks of Material Misstatement (Ref: Para. A184–A185)

Identifying Risks of Material Misstatement

28. The auditor shall identify the risks of material misstatement and determine whether they exist at: (Ref: Para. A186–A192)
    (a) The financial statement level; (Ref: Para. A193–A200) or
    (b) The assertion level for classes of transactions, account balances and disclosures. (Ref: Para. A201)

29. The auditor shall determine the relevant assertions and the related significant classes of transactions, account balances and disclosures. (Ref: Para. A202–A204)

Assessing Risks of Material Misstatement at the Financial Statement Level

30. For identified risks of material misstatement at the financial statement level, the auditor shall assess the risks and: (Ref: Para. A193–A200)
    (a) Determine whether such risks affect the assessment of risks at the assertion level; and
    (b) Evaluate the nature and extent of their pervasive effect on the financial statements.

Assessing Risks of Material Misstatement at the Assertion Level

Assessing Inherent Risk (Ref: Para. A205–A217)

31. For identified risks of material misstatement at the assertion level, the auditor shall assess inherent risk by assessing the likelihood and magnitude of misstatement. In doing so, the auditor shall take into account how, and the degree to which:
    (a) Inherent risk factors affect the susceptibility of relevant assertions to misstatement; and
    (b) The risks of material misstatement at the financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level. (Ref: Para. A215–A216)
32. The auditor shall determine whether any of the assessed risks of material misstatement are significant risks. (Ref: Para. A218–A221)
33. The auditor shall determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material misstatement at the assertion level. (Ref: Para. A222–A225)

Assessing Control Risk

34. If the auditor plans to test the operating effectiveness of controls, the auditor shall assess control risk. If the auditor does not plan to test the operating effectiveness of controls, the auditor's assessment of control risk shall be such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk. (Ref: Para. A226–A229)

Evaluating the Audit Evidence Obtained from the Risk Assessment Procedures

35. The auditor shall evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, the auditor shall perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis. In identifying and assessing the risks of material misstatement, the auditor shall take into account all audit evidence obtained from the risk assessment procedures, whether corroborative or contradictory to assertions made by management. (Ref: Para. A230–A232)

Classes of Transactions, Account Balances and Disclosures that Are Not Significant, but Which Are Material

36. For material classes of transactions, account balances or disclosures that have not been determined to be significant classes of transactions, account balances or disclosures, the

auditor shall evaluate whether the auditor's determination remains appropriate. (Ref: Para. A233–A235)

Revision of Risk Assessment

37. If the auditor obtains new information which is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the risks of material misstatement, the auditor shall revise the identification or assessment. (Ref: Para. A236)

Documentation

38. The auditor shall include in the audit documentation:[13] (Ref: Para. A237–A241)
    (a) The discussion among the engagement team and the significant decisions reached;
    (b) Key elements of the auditor's understanding in accordance with paragraphs 19, 21, 22, 24 and 25; the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed;
    (c) The evaluation of the design of identified controls, and determination whether such controls have been implemented, in accordance with the requirements in paragraph 26; and
    (d) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgements made.

Application and Other Explanatory Material

Definitions (Ref: Para. 12)

Assertions (Ref: Para. 12(a))

A1. Categories of assertions are used by auditors to consider the different types of potential misstatements that may occur when identifying, assessing and responding to the risks of material misstatement. Examples of these categories of assertions are described in paragraph A190. The assertions differ from the written representations required by ISA (NZ) 580,[14] to confirm certain matters or support other audit evidence.

Controls (Ref: Para. 12(c))

A2. Controls are embedded within the components of the entity's system of internal control.

A3. Policies are implemented through the actions of personnel within the entity, or through the restraint of personnel from taking actions that would conflict with such policies.

A4. Procedures may be mandated, through formal documentation or other communication by management or those charged with governance, or may result from behaviours that are not mandated but are rather conditioned by the entity's culture. Procedures may be

[13] ISA (NZ) 230, *Audit Documentation*, paragraphs 8–11, and A6–A7

[14] ISA (NZ) 580, *Written Representations*

enforced through the actions permitted by the IT applications used by the entity or other aspects of the entity's IT environment.

A5. Controls may be direct or indirect. Direct controls are controls that are precise enough to address risks of material misstatement at the assertion level. Indirect controls are controls that support direct controls.

Information Processing Controls (Ref: Para. 12(e))

A6. Risks to the integrity of information arise from susceptibility to ineffective implementation of the entity's information policies, which are policies that define the information flows, records and reporting processes in the entity's information system. Information processing controls are procedures that support effective implementation of the entity's information policies. Information processing controls may be automated (i.e., embedded in IT applications) or manual (e.g., input or output controls) and may rely on other controls, including other information processing controls or general IT controls.

Inherent Risk Factors (Ref: Para. 12(f))

Appendix 2 sets out further considerations relating to understanding inherent risk factors.

A7. Inherent risk factors may be qualitative or quantitative and affect the susceptibility of assertions to misstatement. Qualitative inherent risk factors relating to the preparation of information required by the applicable financial reporting framework include:

- Complexity;
- Subjectivity;
- Change;
- Uncertainty; or
- Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk.

A8. Other inherent risk factors, that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure may include:

- The quantitative or qualitative significance of the class of transactions, account balance or disclosure; or
- The volume or a lack of uniformity in the composition of the items to be processed through the class of transactions or account balance, or to be reflected in the disclosure.

Relevant Assertions (Ref: Para. 12(h))

A9. A risk of material misstatement may relate to more than one assertion, in which case all the assertions to which such a risk relates are relevant assertions. If an assertion does not have an identified risk of material misstatement, then it is not a relevant assertion.

Significant Risk (Ref: Para. 12(l))

A10. Significance can be described as the relative importance of a matter, and is judged by the auditor in the context in which the matter is being considered. For inherent risk, significance may be considered in the context of how, and the degree to which, inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur.

Risk Assessment Procedures and Related Activities (Ref: Para. 13–18)

A11. The risks of material misstatement to be identified and assessed include both those due to fraud and those due to error, and both are covered by this ISA (NZ). However, the significance of fraud is such that further requirements and guidance are included in ISA (NZ) 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify and assess the risks of material misstatement due to fraud.[15] In addition, the following ISAs (NZ) provide further requirements and guidance on identifying and assessing risks of material misstatement regarding specific matters or circumstances:

- ISA (NZ) 540 (Revised)[16] in regard to accounting estimates;
- ISA (NZ) 550[22] in regard to related party relationships and transactions;
- ISA (NZ) 570 (Revised)[17] in regard to going concern; and
- ISA (NZ) 600[18] in regard to group financial statements.

A12. Professional scepticism is necessary for the critical assessment of audit evidence gathered when performing the risk assessment procedures, and assists the auditor in remaining alert to audit evidence that is not biased towards corroborating the existence of risks or that may be contradictory to the existence of risks. Professional scepticism is an attitude that is applied by the auditor when making professional judgements that then provides the basis for the auditor's actions. The auditor applies professional judgement in determining when the auditor has audit evidence that provides an appropriate basis for risk assessment.

A13. The application of professional scepticism by the auditor may include:

- Questioning contradictory information and the reliability of documents;
- Considering responses to enquiries and other information obtained from management and those charged with governance;
- Being alert to conditions that may indicate possible misstatement due to fraud or error; and

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15 ISA (NZ) 240, paragraphs 12–27

16 ISA (NZ) 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

17 ISA (NZ) 570 (Revised), *Going Concern*

18 ISA (NZ) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

- Considering whether audit evidence obtained supports the auditor's identification and assessment of the risks of material misstatement in light of the entity's nature and circumstances.

Why Obtaining Audit Evidence in an Unbiased Manner Is Important (Ref: Para. 13)

A14. Designing and performing risk assessment procedures to obtain audit evidence to support the identification and assessment of the risks of material misstatement in an unbiased manner may assist the auditor in identifying potentially contradictory information, which may assist the auditor in exercising professional scepticism in identifying and assessing the risks of material misstatement.

Sources of Audit Evidence (Ref: Para. 13)

A15. Designing and performing risk assessment procedures to obtain audit evidence in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence. In addition to information from other sources[19], sources of information for risk assessment procedures may include:

- Interactions with management, those charged with governance, and other key entity personnel, such as internal auditors.
- Certain external parties such as regulators, whether obtained directly or indirectly.
- Publicly available information about the entity, for example entity-issued press releases, materials for analysts or investor group meetings, analysts' reports or information about trading activity.

Regardless of the source of information, the auditor considers the relevance and reliability of the information to be used as audit evidence in accordance with ISA (NZ) 500.[20]

Scalability (Ref: Para. 13)

A16. The nature and extent of risk assessment procedures will vary based on the nature and circumstances of the entity (e.g., the formality of the entity's policies and procedures, and processes and systems). The auditor uses professional judgement to determine the nature and extent of the risk assessment procedures to be performed to meet the requirements of this ISA (NZ).

A17. Although the extent to which an entity's policies and procedures, and processes and systems are formalized may vary, the auditor is still required to obtain the understanding in accordance with paragraphs 19, 21, 22, 24, 25 and 26.

Examples:

Some entities, including less complex entities, and particularly owner-managed entities, may not have established structured processes and systems (e.g., a risk assessment process or a process to monitor the system of internal control) or may have established processes or systems

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19 See paragraphs A37 and A38.

20 ISA (NZ) 500, *Audit Evidence*, paragraph 7

with limited documentation or a lack of consistency in how they are undertaken. When such systems and processes lack formality, the auditor may still be able to perform risk assessment procedures through observation and enquiry.

Other entities, typically more complex entities, are expected to have more formalized and documented policies and procedures. The auditor may use such documentation in performing risk assessment procedures.

A18. The nature and extent of risk assessment procedures to be performed the first time an engagement is undertaken may be more extensive than procedures for a recurring engagement. In subsequent periods, the auditor may focus on changes that have occurred since the preceding period.

Types of Risk Assessment Procedures (Ref: Para. 14)

A19. ISA (NZ) 500[21] explains the types of audit procedures that may be performed in obtaining audit evidence from risk assessment procedures and further audit procedures. The nature, timing and extent of the audit procedures may be affected by the fact that some of the accounting data and other evidence may only be available in electronic form or only at certain points in time.[22] The auditor may perform substantive procedures or tests of controls, in accordance with ISA (NZ) 330, concurrently with risk assessment procedures, when it is efficient to do so. Audit evidence obtained that supports the identification and assessment of risks of material misstatement may also support the detection of misstatements at the assertion level or the evaluation of the operating effectiveness of controls.

A20. Although the auditor is required to perform all the risk assessment procedures described in paragraph 14 in the course of obtaining the required understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control (see paragraphs 19–26), the auditor is not required to perform all of them for each aspect of that understanding. Other procedures may be performed when the information to be obtained may be helpful in identifying risks of material misstatement. Examples of such procedures may include making enquiries of the entity's external legal counsel or external supervisors, or of valuation experts that the entity has used.

Automated Tools and Techniques (Ref: Para. 14)

A21. Using automated tools and techniques, the auditor may perform risk assessment procedures on large volumes of data (from the general ledger, sub-ledgers or other operational data) including for analysis, recalculations, reperformance or reconciliations.

21 ISA (NZ) 500, paragraphs A14–A17 and A21–A25

22 ISA (NZ) 500, paragraph A12

Enquiries of Management and Others within the Entity (Ref: Para. 14(a))

Why Enquiries Are Made of Management and Others Within the Entity

A22. Information obtained by the auditor to support an appropriate basis for the identification and assessment of risks, and the design of further audit procedures, may be obtained through enquiries of management and those responsible for financial reporting.

A23. Enquiries of management and those responsible for financial reporting and of other appropriate individuals within the entity and other employees with different levels of authority may offer the auditor varying perspectives when identifying and assessing risks of material misstatement.

> **Examples**:
>
> - Enquiries directed towards those charged with governance may help the auditor understand the extent of oversight by those charged with governance over the preparation of the financial statements by management. ISA (NZ) 260 (Revised)[23] identifies the importance of effective two-way communication in assisting the auditor to obtain information from those charged with governance in this regard.
> - Enquiries of employees responsible for initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
> - Enquiries directed towards in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners, and the meaning of contractual terms.
> - Enquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
> - Enquiries directed towards the risk management function (or enquiries of those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
> - Enquiries directed towards IT personnel may provide information about system changes, system or control failures, or other IT-related risks.

Considerations Specific to Public Sector Entities

A24. When making enquiries of those who may have information that is likely to assist in identifying risks of material misstatement, auditors of public sector entities may obtain information from additional sources such as from the auditors that are involved in performance or other audits related to the entity.

23 ISA (NZ) 260 (Revised), *Communication with Those Charged with Governance*, paragraph 4(b)

Enquiries of the Internal Audit Function

Appendix 4 sets out considerations for understanding an entity's internal audit function.

Why enquiries are made of the internal audit function (if the function exists)

A25. If an entity has an internal audit function, enquiries of the appropriate individuals within the function may assist the auditor in understanding the entity and its environment, and the entity's system of internal control, in the identification and assessment of risks.

Considerations specific to public sector entities

A26. Auditors of public sector entities often have additional responsibilities with regard to internal control and compliance with applicable laws and regulations. Enquiries of appropriate individuals in the internal audit function may assist the auditors in identifying the risk of material non-compliance with applicable laws and regulations, and the risk of control deficiencies related to financial reporting.

Analytical Procedures (Ref: Para. 14(b))

Why Analytical Procedures Are Performed as a Risk Assessment Procedure

A27. Analytical procedures help identify inconsistencies, unusual transactions or events, and amounts, ratios, and trends that indicate matters that may have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

A28. Analytical procedures performed as risk assessment procedures may therefore assist in identifying and assessing the risks of material misstatement by identifying aspects of the entity of which the auditor was unaware or understanding how inherent risk factors, such as change, affect susceptibility of assertions to misstatement.

Types of Analytical Procedures

A29. Analytical procedures performed as risk assessment procedures may:

- Include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold (non-financial).
- Use data aggregated at a high level. Accordingly, the results of those analytical procedures may provide a broad initial indication about the likelihood of a material misstatement.

> **Example**:
>
> In the audit of many entities, including those with less complex business models and processes, and a less complex information system, the auditor may perform a simple comparison of information, such as the change in interim or monthly account balances from balances in prior periods, to obtain an indication of potentially higher risk areas.

A30. This ISA (NZ) deals with the auditor's use of analytical procedures as risk assessment procedures. ISA (NZ) 520[24] deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures") and the auditor's responsibility to perform analytical procedures near the end of the audit. Accordingly, analytical procedures performed as risk assessment procedures are not required to be performed in accordance with the requirements of ISA (NZ) 520. However, the requirements and application material in ISA (NZ) 520 may provide useful guidance to the auditor when performing analytical procedures as part of the risk assessment procedures.

Automated tools and techniques

A31. Analytical procedures can be performed using a number of tools or techniques, which may be automated. Applying automated analytical procedures to the data may be referred to as data analytics.

> **Example**:
>
> The auditor may use a spreadsheet to perform a comparison of actual recorded amounts to budgeted amounts, or may perform a more advanced procedure by extracting data from the entity's information system, and further analysing this data using visualisation techniques to identify classes of transactions, account balances or disclosures for which further specific risk assessment procedures may be warranted.

Observation and Inspection (Ref: Para. 14(c))

Why Observation and Inspection Are Performed as Risk Assessment Procedures

A32. Observation and inspection may support, corroborate or contradict enquiries of management and others, and may also provide information about the entity and its environment.

Scalability

A33. Where policies or procedures are not documented, or the entity has less formalised controls, the auditor may still be able to obtain some audit evidence to support the identification and assessment of the risks of material misstatement through observation or inspection of the performance of the control.

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24 ISA (NZ) 520, *Analytical Procedures*

> **Examples**:
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> - The auditor may obtain an understanding of controls over an inventory count, even if they have not been documented by the entity, through direct observation.
> - The auditor may be able to observe segregation of duties.
> - The auditor may be able to observe passwords being entered.

Observation and Inspection as Risk Assessment Procedures

A34. Risk assessment procedures may include observation or inspection of the following:

- The entity's operations.
- Internal documents (such as business plans and strategies), records, and internal control manuals.
- Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of directors' meetings).
- The entity's premises and plant facilities.
- Information obtained from external sources such as trade and economic journals; reports by analysts, banks, or rating agencies; regulatory or financial publications; or other external documents about the entity's financial performance (such as those referred to in paragraph A79).
- The behaviours and actions of management or those charged with governance (such as the observation of an audit committee meeting).

Automated tools and techniques

A35. Automated tools or techniques may also be used to observe or inspect, in particular assets, for example through the use of remote observation tools (e.g., a drone).

Considerations Specific to Public Sector Entities

A36. Risk assessment procedures performed by auditors of public sector entities may also include observation and inspection of documents prepared by management for the legislature, for example documents related to mandatory performance reporting.

Information from Other Sources (Ref: Para. 15)

Why the Auditor Considers Information from Other Sources

A37. Information obtained from other sources may be relevant to the identification and assessment of the risks of material misstatement by providing information and insights about:

- The nature of the entity and its business risks, and what may have changed from previous periods.

- The integrity and ethical values of management and those charged with governance, which may also be relevant to the auditor's understanding of the control environment.
- The applicable financial reporting framework and its application to the nature and circumstances of the entity.

Other Relevant Sources

A38. Other relevant sources of information include:

- The auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement in accordance with ISA (NZ) 220, including the conclusions reached thereon.[25]
- Other engagements performed for the entity by the engagement partner. The engagement partner may have obtained knowledge relevant to the audit, including about the entity and its environment, when performing other engagements for the entity. Such engagements may include agreed-upon procedures engagements or other audit or assurance engagements, including engagements to address incremental reporting requirements in the jurisdiction.

Information from the Auditor's Previous Experience with the Entity and Previous Audits (Ref: Para. 16)

Why information from previous audits is important to the current audit

A39. The auditor's previous experience with the entity and from audit procedures performed in previous audits may provide the auditor with information that is relevant to the auditor's determination of the nature and extent of risk assessment procedures, and the identification and assessment of risks of material misstatement.

Nature of the Information from Previous Audits

A40. The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about such matters as:

- Past misstatements and whether they were corrected on a timely basis.
- The nature of the entity and its environment, and the entity's system of internal control (including control deficiencies).
- Significant changes that the entity or its operations may have undergone since the prior financial period.
- Those particular types of transactions and other events or account balances (and related disclosures) where the auditor experienced difficulty in performing the necessary audit procedures, for example, due to their complexity.

A41. The auditor is required to determine whether information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous

[25] ISA (NZ) 220, *Quality Control for an Audit of Financial Statements,* paragraph 12

audits remains relevant and reliable, if the auditor intends to use that information for the purposes of the current audit. If the nature or circumstances of the entity have changed, or new information has been obtained, the information from prior periods may no longer be relevant or reliable for the current audit. To determine whether changes have occurred that may affect the relevance or reliability of such information, the auditor may make enquiries and perform other appropriate audit procedures, such as walk-throughs of relevant systems. If the information is not reliable, the auditor may consider performing additional procedures that are appropriate in the circumstances.

Engagement Team Discussion (Ref: Para. 17–18)

Why the Engagement Team Is Required to Discuss the Application of the Applicable Financial Reporting Framework and the Susceptibility of the Entity's Financial Statements to Material Misstatement

A42. The discussion among the engagement team about the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement:

- Provides an opportunity for more experienced engagement team members, including the engagement partner, to share their insights based on their knowledge of the entity. Sharing information contributes to an enhanced understanding by all engagement team members.
- Allows the engagement team members to exchange information about the business risks to which the entity is subject, how inherent risk factors may affect the susceptibility to misstatement of 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.
- 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.
- 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.

ISA (NZ) 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.[26]

A43. Professional scepticism is necessary for the critical assessment of audit evidence, and a robust and open engagement team discussion, including for recurring audits, may lead to

[26] ISA (NZ) 240, paragraph 16

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 for which exercising professional scepticism may be particularly important, and may lead to the involvement of more experienced members of the engagement team who are appropriately skilled to be involved in the performance of audit procedures related to those areas.

Scalability

A44. 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 A46 nonetheless may assist the auditor in identifying where there may be risks of material misstatement.

A45. When an engagement is carried out by a large engagement team, such as for an audit of group financial statements, it is not always necessary or practical for the discussion to include all members in a single discussion (for example, in a multi-location audit), nor is it necessary for all the members of the engagement team to be informed of all the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team including, if considered appropriate, those with specific skills or knowledge, and those responsible for the audits of components, while delegating discussion with others, taking into account the extent of communication considered necessary throughout the engagement team. A communications plan, agreed by the engagement partner, may be useful.

Discussion of Disclosures in the Applicable Financial Reporting Framework

A46. As part of the discussion among the engagement team, consideration of the disclosure requirements of the applicable financial reporting framework assists in identifying early in the audit where there may be risks of material misstatement in relation to disclosures, even in circumstances where the applicable financial reporting framework only requires simplified disclosures. Matters the engagement team may discuss include:

- Changes in financial reporting requirements that may result in significant new or revised disclosures;
- Changes in the entity's environment, financial condition or activities that may result in significant new or revised disclosures, for example, a significant business combination in the period under audit;
- Disclosures for which obtaining sufficient appropriate audit evidence may have been difficult in the past; and
- Disclosures about complex matters, including those involving significant management judgement as to what information to disclose.

Considerations Specific to Public Sector Entities

A47. As part of the discussion among the engagement team by auditors of public sector entities, consideration may also be given to any additional broader objectives, and related risks, arising from the audit mandate or obligations for public sector entities.

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control (Ref: Para. 19–27)

> **Appendices 1 through 6** set out further considerations relating to obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control.

Obtaining the Required Understanding (Ref: Para. 19–27)

A48. Obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control is a dynamic and iterative process of gathering, updating and analysing information and continues throughout the audit. Therefore, the auditor's expectations may change as new information is obtained.

A49. The auditor's understanding of the entity and its environment and the applicable financial reporting framework may also assist the auditor in developing initial expectations about the classes of transactions, account balances and disclosures that may be significant classes of transactions, account balances and disclosures. These expected significant classes of transactions, account balances and disclosures form the basis for the scope of the auditor's understanding of the entity's information system.

Why an Understanding of the Entity and Its Environment, and the Applicable Financial Reporting Framework Is Required (Ref: Para. 19–20)

A50. The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, assists the auditor in understanding the events and conditions that are relevant to the entity, and in identifying how inherent risk factors affect the susceptibility of assertions to misstatement in the preparation of the financial statements, in accordance with the applicable financial reporting framework, and the degree to which they do so. Such information establishes a frame of reference within which the auditor identifies and assesses risks of material misstatement. This frame of reference also assists the auditor in planning the audit and exercising professional judgement and professional scepticism throughout the audit, for example, when:

- Identifying and assessing risks of material misstatement of the financial statements in accordance with ISA (NZ) 315 (Revised 2019) or other relevant standards (e.g., relating to risks of fraud in accordance with ISA (NZ) 240 or when identifying or assessing risks related to accounting estimates in accordance with ISA (NZ) 540 (Revised));
- Performing procedures to help identify instances of non-compliance with laws and regulations that may have a material effect on the financial statements in accordance with ISA (NZ) 250;[27]

[27] ISA (NZ) 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements,* paragraph 14

- Evaluating whether the financial statements provide adequate disclosures in accordance with ISA (NZ) 700 (Revised);[28]
- Determining materiality or performance materiality in accordance with ISA (NZ) 320;[29] or
- Considering the appropriateness of the selection and application of accounting policies, and the adequacy of financial statement disclosures.

A51. [Amended by the NZAuASB]

NZ A51. The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, also informs how the auditor plans and performs further audit procedures, for example, when:

- Developing expectations for use when performing analytical procedures in accordance with ISA (NZ) 520;[30]
- Designing and performing further audit procedures to obtain sufficient appropriate audit evidence in accordance with ISA (NZ) 330; and
- Evaluating the sufficiency and appropriateness of audit evidence obtained (e.g., relating to assumptions or management's and, where appropriate, those charged with governance's oral and written representations).

Scalability

A52. The nature and extent of the required understanding is a matter of the auditor's professional judgement and varies from entity to entity based on the nature and circumstances of the entity, including:

- The size and complexity of the entity, including its IT environment;
- The auditor's previous experience with the entity;
- The nature of the entity's systems and processes, including whether they are formalised or not; and
- The nature and form of the entity's documentation.

A53. The auditor's risk assessment procedures to obtain the required understanding may be less extensive in audits of less complex entities and more extensive for entities that are more complex. The depth of the understanding that is required by the auditor is expected to be less than that possessed by management in managing the entity.

A54. Some financial reporting frameworks allow smaller entities to provide simpler and less detailed disclosures in the financial statements. However, this does not relieve the auditor of the responsibility to obtain an understanding of the entity and its environment and the applicable financial reporting framework as it applies to the entity.

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28 ISA (NZ) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements,* paragraph 13(e)

29 ISA (NZ) 320, *Materiality in Planning and Performing an Audit*, paragraphs 10–11

30 ISA (NZ) 520, paragraph 5

A55. The entity's use of IT and the nature and extent of changes in the IT environment may also affect the specialised skills that are needed to assist with obtaining the required understanding.

The Entity and Its Environment (Ref: Para. 19(a))

The Entity's Organisational Structure, Ownership and Governance, and Business Model (Ref: Para. 19(a)(i))

The entity's organisational structure and ownership

A56. An understanding of the entity's organisational structure and ownership may enable the auditor to understand such matters as:

- The complexity of the entity's structure.

> **Example**:
>
> The entity may be a single entity or the entity's structure may include subsidiaries, divisions or other components in multiple locations. Further, the legal structure may be different from the operating structure. Complex structures often introduce factors that may give rise to increased susceptibility to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or special-purpose entities are accounted for appropriately and whether adequate disclosure of such issues in the financial statements has been made.

- The ownership, and relationships between owners and other people or entities, including related parties. This understanding may assist in determining whether related party transactions have been appropriately identified, accounted for, and adequately disclosed in the financial statements.[31]
- The distinction between the owners, those charged with governance and management.

> **Example**:
>
> In less complex entities, owners of the entity may be involved in managing the entity, therefore there is little or no distinction. In contrast, such as in some listed entities, there may be a clear distinction between management, the owners of the entity, and those charged with governance.[32]

- The structure and complexity of the entity's IT environment.

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31 ISA (NZ) 550 establishes requirements and provide guidance on the auditor's considerations relevant to related parties.

32 ISA (NZ) 260 (Revised), paragraphs A1 and A2, provide guidance on the identification of those charged with governance and explains that in some cases, some or all of those charged with governance may be involved in managing the entity.

> **Examples**:
>
> An entity may:
>
> - Have multiple legacy IT systems in diverse businesses that are not well integrated resulting in a complex IT environment.
> - Be using external or internal service providers for aspects of its IT environment (e.g., outsourcing the hosting of its IT environment to a third party or using a shared service centre for central management of IT processes in a group).

Automated tools and techniques

A57. The auditor may use automated tools and techniques to understand flows of transactions and processing as part of the auditor's procedures to understand the information system. An outcome of these procedures may be that the auditor obtains information about the entity's organisational structure or those with whom the entity conducts business (e.g., vendors, customers, related parties).

Considerations specific to public sector entities

A58. Ownership of a public sector entity may not have the same relevance as in the private sector because decisions related to the entity may be made outside of the entity as a result of political processes. Therefore, management may not have control over certain decisions that are made. Matters that may be relevant include understanding the ability of the entity to make unilateral decisions, and the ability of other public sector entities to control or influence the entity's mandate and strategic direction.

> **Example**:
>
> A public sector entity may be subject to laws or other directives from authorities that require it to obtain approval from parties external to the entity of its strategy and objectives prior to it implementing them. Therefore, matters related to understanding the legal structure of the entity may include applicable laws and regulations, and the classification of the entity (i.e., whether the entity is a ministry, department, agency or other type of entity).

Governance

Why the auditor obtains an understanding of governance

A59. Understanding the entity's governance may assist the auditor with understanding the entity's ability to provide appropriate oversight of its system of internal control. However, this understanding may also provide evidence of deficiencies, which may indicate an increase in the susceptibility of the entity's financial statements to risks of material misstatement.

Understanding the entity's governance

A60. Matters that may be relevant for the auditor to consider in obtaining an understanding of the governance of the entity include:

- Whether any or all of those charged with governance are involved in managing the entity.
- The existence (and separation) of a non-executive Board, if any, from executive management.
- Whether those charged with governance hold positions that are an integral part of the entity's legal structure, for example as directors.
- The existence of sub-groups of those charged with governance, such as an audit committee, and the responsibilities of such a group.
- The responsibilities of those charged with governance for oversight of financial reporting, including approval of the financial statements.

The Entity's Business Model

Appendix 1 sets out additional considerations for obtaining an understanding of the entity and its business model, as well as additional considerations for auditing special purpose entities.

Why the auditor obtains an understanding of the entity's business model

A61. Understanding the entity's objectives, strategy and business model helps the auditor to understand the entity at a strategic level, and to understand the business risks the entity takes and faces. An understanding of the business risks that have an effect on the financial statements assists the auditor in identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the financial statements.

Examples:

An entity's business model may rely on the use of IT in different ways:

- The entity sells shoes from a physical store, and uses an advanced stock and point of sale system to record the selling of shoes; or
- The entity sells shoes online so that all sales transactions are processed in an IT environment, including initiation of the transactions through a website.

For both of these entities the business risks arising from a significantly different business model would be substantially different, notwithstanding both entities sell shoes.

Understanding the entity's business model

A62. Not all aspects of the business model are relevant to the auditor's understanding. Business risks are broader than the risks of material misstatement of the financial statements, although business risks include the latter. The auditor does not have a responsibility to understand or identify all business risks because not all business risks give rise to risks of material misstatement.

A63. Business risks increasing the susceptibility to risks of material misstatement may arise from:

- Inappropriate objectives or strategies, ineffective execution of strategies, or change or complexity.
- A failure to recognise the need for change may also give rise to business risk, for example, from:
  - The development of new products or services that may fail;
  - A market which, even if successfully developed, is inadequate to support a product or service; or
  - Flaws in a product or service that may result in legal liability and reputational risk.
- Incentives and pressures on management, which may result in intentional or unintentional management bias, and therefore affect the reasonableness of significant assumptions and the expectations of management or those charged with governance.

A64. Examples of matters that the auditor may consider when obtaining an understanding of the entity's business model, objectives, strategies and related business risks that may result in a risk of material misstatement of the financial statements include:

- Industry developments, such as the lack of personnel or expertise to deal with the changes in the industry;
- New products and services that may lead to increased product liability;
- Expansion of the entity's business, and demand has not been accurately estimated;
- New accounting requirements where there has been incomplete or improper implementation;
- Regulatory requirements resulting in increased legal exposure;
- Current and prospective financing requirements, such as loss of financing due to the entity's inability to meet requirements;
- Use of IT, such as the implementation of a new IT system that will affect both operations and financial reporting; or
- The effects of implementing a strategy, particularly any effects that will lead to new accounting requirements.

A65. Ordinarily, management identifies business risks and develops approaches to address them. Such a risk assessment process is part of the entity's system of internal control and is discussed in paragraph 22, and paragraphs A109–A113.

Considerations specific to public sector entities

A66. Entities operating in the public sector may create and deliver value in different ways to those creating wealth for owners but will still have a 'business model' with a specific objective. Matters public sector auditors may obtain an understanding of that are relevant to the business model of the entity, include:

- Knowledge of relevant government activities, including related programmes.
- Programme objectives and strategies, including public policy elements.

A67. For the audits of public sector entities, "management objectives" may be influenced by requirements to demonstrate public accountability and may include objectives which have their source in law, regulation or other authority.

Industry, Regulatory and Other External Factors (Ref: Para. 19(a)(ii))

Industry factors

A68. Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments. Matters the auditor may consider include:

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

A69. The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of regulation.

> **Example**:
>
> In the construction industry, long-term contracts may involve significant estimates of revenues and expenses that give rise to risks of material misstatement. In such cases, it is important that the engagement team include members with sufficient relevant knowledge and experience.[33]

Regulatory factors

A70. Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment and any changes thereto. Matters the auditor may consider include:

- Regulatory framework for a regulated industry, for example, prudential requirements, including related disclosures.
- Legislation and regulation that significantly affect the entity's operations, for example, labour laws and regulations.
- Taxation legislation and regulations.

33 ISA (NZ) 220, paragraph 14

- Government policies currently affecting the conduct of the entity's business, such as monetary, including foreign exchange controls, fiscal, financial incentives (for example, government aid programmes), and tariffs or trade restriction policies.
- Environmental requirements affecting the industry and the entity's business.

A71. ISA (NZ) 250 (Revised) includes some specific requirements related to the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates.[34]

Considerations specific to public sector entities

A72. For the audits of public sector entities, there may be particular laws or regulations that affect the entity's operations. Such elements may be an essential consideration when obtaining an understanding of the entity and its environment.

Other external factors

A73. Other external factors affecting the entity that the auditor may consider include the general economic conditions, interest rates and availability of financing, and inflation or currency revaluation.

Measures Used by Management to Assess the Entity's Financial Performance (Ref: Para. 19(a)(iii))

Why the auditor understands measures used by management

A74. An understanding of the entity's measures assists the auditor in considering whether such measures, whether used externally or internally, create pressures on the entity to achieve performance targets. These pressures may motivate management to take actions that increase the susceptibility to misstatement due to management bias or fraud (e.g., to improve the business performance or to intentionally misstate the financial statements) (see ISA (NZ) 240 for requirements and guidance in relation to the risks of fraud).

A75. Measures may also indicate to the auditor the likelihood of risks of material misstatement of related financial statement information. For example, performance measures may indicate that the entity has unusually rapid growth or profitability when compared to that of other entities in the same industry.

Measures used by management

A76. Management and others ordinarily measure and review those matters they regard as important. Enquiries of management may reveal that it relies on certain key indicators, whether publicly available or not, for evaluating financial performance and taking action. In such cases, the auditor may identify relevant performance measures, whether internal or external, by considering the information that the entity uses to manage its business. If such enquiry indicates an absence of performance measurement or review, there may be an increased risk of misstatements not being detected and corrected.

A77. Key indicators used for evaluating financial performance may include:

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[34] ISA (NZ) 250 (Revised), paragraph 13

- Key performance indicators (financial and non-financial) and key ratios, trends and operating statistics.
- Period-on-period financial performance analyses.
- Budgets, forecasts, variance analyses, segment information and divisional, departmental or other level performance reports.
- Employee performance measures and incentive compensation policies.
- Comparisons of an entity's performance with that of competitors.

Scalability (Ref: Para. 19(a)(iii))

A78. The procedures undertaken to understand the entity's measures may vary depending on the size or complexity of the entity, as well as the involvement of owners or those charged with governance in the management of the entity.

Examples:

- For some less complex entities, the terms of the entity's bank borrowings (i.e., bank covenants) may be linked to specific performance measures related to the entity's performance or financial position (e.g., a maximum working capital amount). The auditor's understanding of the performance measures used by the bank may help identify areas where there is increased susceptibility to the risk of material misstatement.
- For some entities whose nature and circumstances are more complex, such as those operating in the insurance or banking industries, performance or financial position may be measured against regulatory requirements (e.g., regulatory ratio requirements such as capital adequacy and liquidity ratios performance hurdles). The auditor's understanding of these performance measures may help identify areas where there is increased susceptibility to the risk of material misstatement.

Other considerations

A79. External parties may also review and analyse the entity's financial performance, in particular for entities where financial information is publicly available. The auditor may also consider publicly available information to help the auditor further understand the business or identify contradictory information such as information from:

- Analysts or credit agencies.
- News and other media, including social media.
- Taxation authorities.
- Regulators.
- Trade unions.
- Providers of finance.

Such financial information can often be obtained from the entity being audited.

A80. The measurement and review of financial performance is not the same as the monitoring of the system of internal control (discussed as a component of the system of internal control in paragraphs A114–A122), though their purposes may overlap:

- The measurement and review of performance is directed at whether business performance is meeting the objectives set by management (or third parties).
- In contrast, monitoring of the system of internal control is concerned with monitoring the effectiveness of controls including those related to management's measurement and review of financial performance.

In some cases, however, performance indicators also provide information that enables management to identify control deficiencies.

Considerations specific to public sector entities

A81. In addition to considering relevant measures used by a public sector entity to assess the entity's financial performance, auditors of public sector entities may also consider non-financial information such as achievement of public benefit outcomes (for example, the number of people assisted by a specific programme).

The Applicable Financial Reporting Framework (Ref: Para. 19(b))

Understanding the Applicable Financial Reporting Framework and the Entity's Accounting Policies

A82. Matters that the auditor may consider when obtaining an understanding of the entity's applicable financial reporting framework, and how it applies in the context of the nature and circumstances of the entity and its environment include:

- The entity's financial reporting practices in terms of the applicable financial reporting framework, such as:
    - o Accounting principles and industry-specific practices, including for industry-specific significant classes of transactions, account balances and related disclosures in the financial statements (for example, loans and investments for banks, or research and development for pharmaceuticals).
    - o Revenue recognition.
    - o Accounting for financial instruments, including related credit losses.
    - o Foreign currency assets, liabilities and transactions.
    - o Accounting for unusual or complex transactions including those in controversial or emerging areas (for example, accounting for cryptocurrency).
- An understanding of the entity's selection and application of accounting policies, including any changes thereto as well as the reasons therefore, may encompass such matters as:
    - o The methods the entity uses to recognise, measure, present and disclose significant and unusual transactions.

- The effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.
- Changes in the environment, such as changes in the applicable financial reporting framework or tax reforms that may necessitate a change in the entity's accounting policies.
- Financial reporting standards and laws and regulations that are new to the entity and when and how the entity will adopt, or comply with, such requirements.

A83. Obtaining an understanding of the entity and its environment may assist the auditor in considering where changes in the entity's financial reporting (e.g., from prior periods) may be expected.

> **Example**:
>
> If the entity has had a significant business combination during the period, the auditor would likely expect changes in classes of transactions, account balances and disclosures associated with that business combination. Alternatively, if there were no significant changes in the financial reporting framework during the period the auditor's understanding may help confirm that the understanding obtained in the prior period remains applicable.

Considerations specific to public sector entities

A84. The applicable financial reporting framework in a public sector entity is determined by the legislative and regulatory frameworks relevant to each jurisdiction or within each geographical area. Matters that may be considered in the entity's application of the applicable financial reporting requirements, and how it applies in the context of the nature and circumstances of the entity and its environment, include whether the entity applies a full accrual basis of accounting or a cash basis of accounting in accordance with the appropriate tier PBE Accounting Requirements in New Zealand.

How Inherent Risk Factors Affect Susceptibility of Assertions to Misstatement (Ref: Para. 19(c))

> **Appendix 2** provides examples of events and conditions that may give rise to the existence of risks of material misstatement, categorised by inherent risk factor.

Why the auditor understands inherent risk factors when understanding the entity and its environment and the applicable financial reporting framework

A85. Understanding the entity and its environment, and the applicable financial reporting framework, assists the auditor in identifying events or conditions, the characteristics of which may affect the susceptibility of assertions about classes of transactions, account balances or disclosures to misstatement. These characteristics are inherent risk factors. Inherent risk factors may affect susceptibility of assertions to misstatement by influencing the likelihood of occurrence of a misstatement or the magnitude of the misstatement if it were to occur. Understanding how inherent risk factors affect the susceptibility of assertions to misstatement may assist the auditor with a preliminary understanding of the likelihood or magnitude of misstatements, which assists the auditor in identifying risks of material misstatement at the assertion level in accordance with paragraph 28(b). Understanding the degree to which inherent risk factors affect susceptibility of assertions to misstatement also assists the auditor in assessing the likelihood and magnitude of a possible misstatement when assessing inherent risk in accordance with paragraph 31(a). Accordingly, understanding the inherent risk factors may also assist the auditor in designing and performing further audit procedures in accordance with ISA (NZ) 330.

A86. The auditor's identification of risks of material misstatement at the assertion level and assessment of inherent risk may also be influenced by audit evidence obtained by the auditor in performing other risk assessment procedures, further audit procedures or in fulfilling other requirements in the ISAs (NZ) (see paragraphs A95, A103, A111, A121, A124 and A151).

The effect of inherent risk factors on a class of transactions, account balance or disclosure

A87. The extent of susceptibility to misstatement of a class of transactions, account balance or disclosure arising from complexity or subjectivity is often closely related to the extent to which it is subject to change or uncertainty.

> **Example**:
>
> If the entity has an accounting estimate that is based on assumptions, the selection of which are subject to significant judgement, the measurement of the accounting estimate is likely to be affected by both subjectivity and uncertainty.

A88. The greater the extent to which a class of transactions, account balance or disclosure is susceptible to misstatement because of complexity or subjectivity, the greater the need for the auditor to apply professional scepticism. Further, when a class of transactions, account balance or disclosure is susceptible to misstatement because of complexity, subjectivity, change or uncertainty, these inherent risk factors may create opportunity for management bias, whether unintentional or intentional, and affect susceptibility to misstatement due to management bias. The auditor's identification of risks of material misstatement, and assessment of inherent risk at the assertion level, are also affected by the interrelationships among inherent risk factors.

A89. Events or conditions that may affect susceptibility to misstatement due to management bias may also affect susceptibility to misstatement due to other fraud risk factors. Accordingly, this may be relevant information for use in accordance with paragraph 24 of ISA (NZ) 240, which requires the auditor to evaluate whether the information obtained from the other risk assessment procedures and related activities indicates that one or more fraud risk factors are present.

Obtaining an Understanding of the Entity's System of Internal Control (Ref: Para. 21–27)

> **Appendix 3** further describes the nature of the entity's system of internal control and inherent limitations of internal control, respectively. Appendix 3 also provides further explanation of the components of a system of internal control for the purposes of the ISAs (NZ).

A90. The auditor's understanding of the entity's system of internal control is obtained through risk assessment procedures performed to understand and evaluate each of the components of the system of internal control as set out in paragraphs 21 to 27.

A91. The components of the entity's system of internal control for the purpose of this ISA (NZ) may not necessarily reflect how an entity designs, implements and maintains its system of internal control, or how it may classify any particular component. Entities may use different terminology or frameworks to describe the various aspects of the system of internal control. For the purpose of an audit, auditors may also use different terminology or frameworks provided all the components described in this ISA (NZ) are addressed.

Scalability

A92. The way in which the entity's system of internal control is designed, implemented and maintained varies with an entity's size and complexity. For example, less complex entities may use less structured or simpler controls (i.e., policies and procedures) to achieve their objectives.

Considerations Specific to Public Sector Entities

A93. Auditors of public sector entities often have additional responsibilities with respect to internal control, for example, to report on compliance with an established code of practice or reporting on spending against budget. Auditors of public sector entities may also have responsibilities to report on compliance with law, regulation or other authority. As a result, their considerations about the system of internal control may be broader and more detailed.

Information Technology in the Components of the Entity's System of Internal Control

> **Appendix 5** provides further guidance on understanding the entity's use of IT in the components of the system of internal control.

A94. The overall objective and scope of an audit does not differ whether an entity operates in a mainly manual environment, a completely automated environment, or an environment involving some combination of manual and automated elements (i.e., manual and automated controls and other resources used in the entity's system of internal control).

Understanding the Nature of the Components of the Entity's System of Internal Control

A95. In evaluating the effectiveness of the design of controls and whether they have been implemented (see paragraphs A175 to A181) the auditor's understanding of each of the components of the entity's system of internal control provides a preliminary understanding of how the entity identifies business risks and how it responds to them. It may also influence the auditor's identification and assessment of the risks of material misstatement in different ways (see paragraph A86). This assists the auditor in designing and performing further audit procedures, including any plans to test the operating effectiveness of controls. For example:

- The auditor's understanding of the entity's control environment, the entity's risk assessment process, and the entity's process to monitor controls components are more likely to affect the identification and assessment of risks of material misstatement at the financial statement level.
- The auditor's understanding of the entity's information system and communication, and the entity's control activities component, are more likely to affect the identification and assessment of risks of material misstatement at the assertion level.

Control Environment, The Entity's Risk Assessment Process and the Entity's Process to Monitor the System of Internal Control (Ref: Para. 21–24)

A96. The controls in the control environment, the entity's risk assessment process and the entity's process to monitor the system of internal control are primarily indirect controls (i.e., controls that are not sufficiently precise to prevent, detect or correct misstatements at the assertion level but which support other controls and may therefore have an indirect effect on the likelihood that a misstatement will be detected or prevented on a timely basis). However, some controls within these components may also be direct controls.

Why the auditor is required to understand the control environment, the entity's risk assessment process and the entity's process to monitor the system of internal control

A97. The control environment provides an overall foundation for the operation of the other components of the system of internal control. The control environment does not directly prevent, or detect and correct, misstatements. It may, however, influence the effectiveness of controls in the other components of the system of internal control. Similarly, the entity's risk assessment process and its process for monitoring the system of internal control are designed to operate in a manner that also supports the entire system of internal control.

A98. Because these components are foundational to the entity's system of internal control, any deficiencies in their operation could have pervasive effects on the preparation of the financial statements. Therefore, the auditor's understanding and evaluations of these components affect the auditor's identification and assessment of risks of material misstatement at the financial statement level, and may also affect the identification and assessment of risks of material misstatement at the assertion level. Risks of material misstatement at the financial statement level affect the auditor's design of overall responses, including, as explained in ISA (NZ) 330, an influence on the nature, timing and extent of the auditor's further procedures.[35]

[35] ISA (NZ) 330, paragraphs A1–A3

Obtaining an understanding of the control environment (Ref: Para. 21)

Scalability

A99. The nature of the control environment in a less complex entity is likely to be different from the control environment in a more complex entity. For example, those charged with governance in less complex entities may not include an independent or outside member, and the role of governance may be undertaken directly by the owner-manager where there are no other owners. Accordingly, some considerations about the entity's control environment may be less relevant or may not be applicable.

A100. In addition, audit evidence about elements of the control environment in less complex entities may not be available in documentary form, in particular where communication between management and other personnel is informal, but the evidence may still be appropriately relevant and reliable in the circumstances.

Examples:

- The organisational structure in a less complex entity will likely be simpler and may include a small number of employees involved in roles related to financial reporting.
- If the role of governance is undertaken directly by the owner-manager, the auditor may determine that the independence of those charged with governance is not relevant.
- Less complex entities may not have a written code of conduct but, instead, develop a culture that emphasizes the importance of integrity and ethical behaviour through oral communication and by management example. Consequently, the attitudes, awareness and actions of management or the owner-manager are of particular importance to the auditor's understanding of a less complex entity's control environment.

Understanding the control environment (Ref: Para. 21(a))

A101. Audit evidence for the auditor's understanding of the control environment may be obtained through a combination of enquiries and other risk assessment procedures (i.e., corroborating enquiries through observation or inspection of documents).

A102. In considering the extent to which management demonstrates a commitment to integrity and ethical values, the auditor may obtain an understanding through enquiries of management and employees, and through considering information from external sources, about:

- How management communicates to employees its views on business practices and ethical behaviour; and
- Inspecting management's written code of conduct and observing whether management acts in a manner that supports that code.

Evaluating the control environment (Ref: Para. 21(b))

Why the auditor evaluates the control environment

A103. The auditor's evaluation of how the entity demonstrates behaviour consistent with the entity's commitment to integrity and ethical values; whether the control environment provides an appropriate foundation for the other components of the entity's system of internal control; and whether any identified control deficiencies undermine the other components of the system of internal control, assists the auditor in identifying potential issues in the other components of the system of internal control. This is because the control environment is foundational to the other components of the entity's system of internal control. This evaluation may also assist the auditor in understanding risks faced by the entity and therefore in identifying and assessing the risks of material misstatement at the financial statement and assertion levels (see paragraph A86).

The auditor's evaluation of the control environment

A104. The auditor's evaluation of the control environment is based on the understanding obtained in accordance with paragraph 21(a).

A105. Some entities may be dominated by a single individual who may exercise a great deal of discretion. The actions and attitudes of that individual may have a pervasive effect on the culture of the entity, which in turn may have a pervasive effect on the control environment. Such an effect may be positive or negative.

> **Example**:
>
> Direct involvement by a single individual may be key to enabling the entity to meet its growth and other objectives, and can also contribute significantly to an effective system of internal control. On the other hand, such concentration of knowledge and authority can also lead to an increased susceptibility to misstatement through management override of controls.

A106. The auditor may consider how the different elements of the control environment may be influenced by the philosophy and operating style of senior management taking into account the involvement of independent members of those charged with governance.

A107. Although the control environment may provide an appropriate foundation for the system of internal control and may help reduce the risk of fraud, an appropriate control environment is not necessarily an effective deterrent to fraud.

> **Example**:
>
> Human resource policies and procedures directed toward hiring competent financial, accounting, and IT personnel may mitigate the risk of errors in processing and recording financial information. However, such policies and procedures may not mitigate the override of controls by senior management (e.g., to overstate earnings).

A108. The auditor's evaluation of the control environment as it relates to the entity's use of IT may include such matters as:

- Whether governance over IT is commensurate with the nature and complexity of the entity and its business operations enabled by IT, including the complexity or maturity of the entity's technology platform or architecture and the extent to which the entity relies on IT applications to support its financial reporting.

- The management organisational structure regarding IT and the resources allocated (for example, whether the entity has invested in an appropriate IT environment and necessary enhancements, or whether a sufficient number of appropriately skilled individuals have been employed including when the entity uses commercial software (with no or limited modifications)).

Obtaining an understanding of the entity's risk assessment process (Ref: Para. 22–23)

Understanding the entity's risk assessment process (Ref: Para. 22(a))

A109. As explained in paragraph A62, not all business risks give rise to risks of material misstatement. In understanding how management and those charged with governance have identified business risks relevant to the preparation of the financial statements, and decided about actions to address those risks, matters the auditor may consider include how management or, as appropriate, those charged with governance, has:

- Specified the entity's objectives with sufficient precision and clarity to enable the identification and assessment of the risks relating to the objectives;
- Identified the risks to achieving the entity's objectives and analysed the risks as a basis for determining how the risks should be managed; and
- Considered the potential for fraud when considering the risks to achieving the entity's objectives.[36]

A110. The auditor may consider the implications of such business risks for the preparation of the entity's financial statements and other aspects of its system of internal control.

Evaluating the entity's risk assessment process (Ref: Para. 22(b))

Why the auditor evaluates whether the entity's risk assessment process is appropriate

A111. The auditor's evaluation of the entity's risk assessment process may assist the auditor in understanding where the entity has identified risks that may occur, and how the entity has responded to those risks. The auditor's evaluation of how the entity identifies its business risks, and how it assesses and addresses those risks assists the auditor in understanding whether the risks faced by the entity have been identified, assessed and addressed as appropriate to the nature and complexity of the entity. This evaluation may also assist the auditor with identifying and assessing financial statement level and assertion level risks of material misstatement (see paragraph A86).

Evaluating whether the entity's risk assessment process is appropriate (Ref: Para. 22(b))

A112. The auditor's evaluation of the appropriateness of the entity's risk assessment process is based on the understanding obtained in accordance with paragraph 22(a).

[36] ISA (NZ) 240, paragraph 19

Scalability

A113. Whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity is a matter of the auditor's professional judgement.

> **Example**:
>
> In some less complex entities, and particularly owner-managed entities, an appropriate risk assessment may be performed through the direct involvement of management or the owner-manager (e.g., the manager or owner-manager may routinely devote time to monitoring the activities of competitors and other developments in the market place to identify emerging business risks). The evidence of this risk assessment occurring in these types of entities is often not formally documented, but it may be evident from the discussions the auditor has with management that management are in fact performing risk assessment procedures.

Obtaining an understanding of the entity's process to monitor the entity's system of internal control (Ref: Para. 24)

Scalability

A114. In less complex entities, and in particular owner-manager entities, the auditor's understanding of the entity's process to monitor the system of internal control is often focused on how management or the owner-manager is directly involved in operations, as there may not be any other monitoring activities.

> **Example**:
>
> Management may receive complaints from customers about inaccuracies in their monthly statement that alerts the owner-manager to issues with the timing of when customer payments are being recognised in the accounting records.

A115. For entities where there is no formal process for monitoring the system of internal control, understanding the process to monitor the system of internal control may include understanding periodic reviews of management accounting information that are designed to contribute to how the entity prevents or detects misstatements.

Understanding the entity's process to monitor the system of internal control (Ref: Para. 24(a))

A116. Matters that may be relevant for the auditor to consider when understanding how the entity monitors its system of internal control include:

- The design of the monitoring activities, for example whether it is periodic or ongoing monitoring;
- The performance and frequency of the monitoring activities;
- The evaluation of the results of the monitoring activities, on a timely basis, to determine whether the controls have been effective; and

- How identified deficiencies have been addressed through appropriate remedial actions, including timely communication of such deficiencies to those responsible for taking remedial action.

A117. The auditor may also consider how the entity's process to monitor the system of internal control addresses monitoring information processing controls that involve the use of IT. This may include, for example:

- Controls to monitor complex IT environments that:
  - o Evaluate the continuing design effectiveness of information processing controls and modify them, as appropriate, for changes in conditions; or
  - o Evaluate the operating effectiveness of information processing controls.
- Controls that monitor the permissions applied in automated information processing controls that enforce the segregation of duties.
- Controls that monitor how errors or control deficiencies related to the automation of financial reporting are identified and addressed.

Understanding the entity's internal audit function (Ref: Para. 24(a)(ii))

Appendix 4 sets out further considerations for understanding the entity's internal audit function.

A118. The auditor's enquiries of appropriate individuals within the internal audit function help the auditor obtain an understanding of the nature of the internal audit function's responsibilities. If the auditor determines that the function's responsibilities are related to the entity's financial reporting, the auditor may obtain further understanding of the activities performed, or to be performed, by the internal audit function by reviewing the internal audit function's audit plan for the period, if any, and discussing that plan with the appropriate individuals within the function. This understanding, together with the information obtained from the auditor's enquiries, may also provide information that is directly relevant to the auditor's identification and assessment of the risks of material misstatement. If, based on the auditor's preliminary understanding of the internal audit function, the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed, ISA (NZ) 610 (Revised 2013)[37] applies.

Other sources of information used in the entity's process to monitor the system of internal control

Understanding the sources of information (Ref: Para. 24(b))

A119. Management's monitoring activities may use information in communications from external parties such as customer complaints or regulator comments that may indicate problems or highlight areas in need of improvement.

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[37] ISA (NZ) 610 (Revised 2013), *Using the Work of Internal Auditors*

Why the auditor is required to understand the sources of information used for the entity's monitoring of the system of internal control

A120. The auditor's understanding of the sources of information used by the entity in monitoring the entity's system of internal control, including whether the information used is relevant and reliable, assists the auditor in evaluating whether the entity's process to monitor the entity's system of internal control is appropriate. If management assumes that information used for monitoring is relevant and reliable without having a basis for that assumption, errors that may exist in the information could potentially lead management to draw incorrect conclusions from its monitoring activities.

Evaluating the entity's process to monitor the system of internal control (Ref: Para 24(c))

Why the auditor evaluates whether the entity's process to monitor the system of internal control is appropriate

A121. The auditor's evaluation about how the entity undertakes ongoing and separate evaluations for monitoring the effectiveness of controls assists the auditor in understanding whether the other components of the entity's system of internal control are present and functioning, and therefore assists with understanding the other components of the entity's system of internal control. This evaluation may also assist the auditor with identifying and assessing financial statement level and assertion level risks of material misstatement (see paragraph A86).

Evaluating whether the entity's process to monitor the system of internal control is appropriate (Ref: Para. 24(c))

A122. The auditor's evaluation of the appropriateness of the entity's process to monitor the system of internal control is based on the auditor's understanding of the entity's process to monitor the system of internal control.

Information System and Communication, and Control Activities (Ref: Para. 25–26)

A123. The controls in the information system and communication, and control activities components are primarily direct controls (i.e., controls that are sufficiently precise to prevent, detect or correct misstatements at the assertion level).

Why the auditor Is required to understand the information system and communication and controls in the control activities component

A124. The auditor is required to understand the entity's information system and communication because understanding the entity's policies that define the flows of transactions and other aspects of the entity's information processing activities relevant to the preparation of the financial statements, and evaluating whether the component appropriately supports the preparation of the entity's financial statements, supports the auditor's identification and assessment of risks of material misstatement at the assertion level. This understanding and evaluation may also result in the identification of risks of material misstatement at the financial statement level when the results of the auditor's procedures are inconsistent with expectations about the entity's system of internal control that may have been set based on information obtained during the engagement acceptance or continuance process (see paragraph A86).

A125. The auditor is required to identify specific controls in the control activities component, and evaluate the design and determine whether the controls have been implemented, as it assists the auditor's understanding about management's approach to addressing certain risks and therefore provides a basis for the design and performance of further audit procedures responsive to these risks as required by ISA (NZ) 330. The higher on the spectrum of inherent risk a risk is assessed, the more persuasive the audit evidence needs to be. Even when the auditor does not plan to test the operating effectiveness of identified controls, the auditor's understanding may still affect the design of the nature, timing and extent of substantive audit procedures that are responsive to the related risks of material misstatement.

The iterative nature of the auditor's understanding and evaluation of the information system and communication, and control activities

A126. As explained in paragraph A49, the auditor's understanding of the entity and its environment, and the applicable financial reporting framework, may assist the auditor in developing initial expectations about the classes of transactions, account balances and disclosures that may be significant classes of transactions, account balances and disclosures. In obtaining an understanding of the information system and communication component in accordance with paragraph 25(a), the auditor may use these initial expectations for the purpose of determining the extent of understanding of the entity's information processing activities to be obtained.

A127. The auditor's understanding of the information system includes understanding the policies that define flows of information relating to the entity's significant classes of transactions, account balances, and disclosures, and other related aspects of the entity's information processing activities. This information, and the information obtained from the auditor's evaluation of the information system may confirm or further influence the auditor's expectations about the significant classes of transactions, account balances and disclosures initially identified (see paragraph A126).

A128. In obtaining an understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through, and out of the entity's information system, the auditor may also identify controls in the control activities component that are required to be identified in accordance with paragraph 26(a). The auditor's identification and evaluation of controls in the control activities component may first focus on controls over journal entries and controls that the auditor plans to test the operating effectiveness of in designing the nature, timing and extent of substantive procedures.

A129. The auditor's assessment of inherent risk may also influence the identification of controls in the control activities component. For example, the auditor's identification of controls relating to significant risks may only be identifiable when the auditor has assessed inherent risk at the assertion level in accordance with paragraph 31. Furthermore, controls addressing risks for which the auditor has determined that substantive procedures alone do not provide sufficient appropriate audit evidence (in accordance with paragraph 33) may also only be identifiable once the auditor's inherent risk assessments have been undertaken.

A130. The auditor's identification and assessment of risks of material misstatement at the assertion level is influenced by both the auditor's:

- Understanding of the entity's policies for its information processing activities in the information system and communication component, and
- Identification and evaluation of controls in the control activities component.

Obtaining an understanding of the information system and communication (Ref: Para. 25)

> **Appendix 3**, Paragraphs 15–19, sets out further considerations relating to the information system and communication.

Scalability

A131. The information system, and related business processes, in less complex entities are likely to be less sophisticated than in larger entities, and are likely to involve a less complex IT environment; however, the role of the information system is just as important. Less complex entities with direct management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the relevant aspects of the entity's information system may therefore require less effort in an audit of a less complex entity, and may involve a greater amount of enquiry than observation or inspection of documentation. The need to obtain an understanding, however, remains important to provide a basis for the design of further audit procedures in accordance with ISA (NZ) 330 and may further assist the auditor in identifying or assessing risks of material misstatement (see paragraph A86).

Obtaining an understanding of the information system (Ref: Para. 25(a))

A132. Included within the entity's system of internal control are aspects that relate to the entity's reporting objectives, including its financial reporting objectives, but may also include aspects that relate to its operations or compliance objectives, when such aspects are relevant to financial reporting. Understanding how the entity initiates transactions and captures information as part of the auditor's understanding of the information system may include information about the entity's systems (its policies) designed to address compliance and operations objectives because such information is relevant to the preparation of the financial statements. Further, some entities may have information systems that are highly integrated such that controls may be designed in a manner to simultaneously achieve financial reporting, compliance and operational objectives, and combinations thereof.

A133. Understanding the entity's information system also includes an understanding of the resources to be used in the entity's information processing activities. Information about the human resources involved that may be relevant to understanding risks to the integrity of the information system include:

- The competence of the individuals undertaking the work;

- Whether there are adequate resources; and
- Whether there is appropriate segregation of duties.

A134. Matters the auditor may consider when understanding the policies that define the flows of information relating to the entity's significant classes of transactions, account balances, and disclosures in the information system and communication component include the nature of:

(a) The data or information relating to transactions, other events and conditions to be processed;

(b) The information processing to maintain the integrity of that data or information; and

(c) The information processes, personnel and other resources used in the information processing process.

A135. Obtaining an understanding of the entity's business processes, which include how transactions are originated, assists the auditor in obtaining an understanding of the entity's information system in a manner that is appropriate to the entity's circumstances.

A136. The auditor's understanding of the information system may be obtained in various ways and may include:

- Enquiries of relevant personnel about the procedures used to initiate, record, process and report transactions or about the entity's financial reporting process;
- Inspection of policy or process manuals or other documentation of the entity's information system;
- Observation of the performance of the policies or procedures by entity's personnel; or
- Selecting transactions and tracing them through the applicable process in the information system (i.e., performing a walk-through).

Automated tools and techniques

A137. The auditor may also use automated techniques to obtain direct access to, or a digital download from, the databases in the entity's information system that store accounting records of transactions. By applying automated tools or techniques to this information, the auditor may confirm the understanding obtained about how transactions flow through the information system by tracing journal entries, or other digital records related to a particular transaction, or an entire population of transactions, from initiation in the accounting records through to recording in the general ledger. Analysis of complete or large sets of transactions may also result in the identification of variations from the normal, or expected, processing procedures for these transactions, which may result in the identification of risks of material misstatement.

Information obtained from outside of the general and subsidiary ledgers

A138. Financial statements may contain information that is obtained from outside of the general and subsidiary ledgers. Examples of such information that the auditor may consider include:

- Information obtained from lease agreements relevant to disclosures in the financial statements.
- Information disclosed in the financial statements that is produced by an entity's risk management system.
- Fair value information produced by management's experts and disclosed in the financial statements.
- Information disclosed in the financial statements that has been obtained from models, or from other calculations used to develop accounting estimates recognised or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as:
  - Assumptions developed internally that may affect an asset's useful life; or
  - Data such as interest rates that are affected by factors outside the control of the entity.
- Information disclosed in the financial statements about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions.
- Information recognised or disclosed in the financial statements that has been obtained from an entity's tax returns and records.
- Information disclosed in the financial statements that has been obtained from analyses prepared to support management's assessment of the entity's ability to continue as a going concern, such as disclosures, if any, related to events or conditions that have been identified that may cast significant doubt on the entity's ability to continue as a going concern.[38]

A139. Certain amounts or disclosures in the entity's financial statements (such as disclosures about credit risk, liquidity risk, and market risk) may be based on information obtained from the entity's risk management system. However, the auditor is not required to understand all aspects of the risk management system, and uses professional judgement in determining the necessary understanding.

The entity's use of information technology in the information system

Why does the auditor understand the IT environment relevant to the information system

A140. The auditor's understanding of the information system includes the IT environment relevant to the flows of transactions and processing of information in the entity's information system because the entity's use of IT applications or other aspects in the IT environment may give rise to risks arising from the use of IT.

A141. The understanding of the entity's business model and how it integrates the use of IT may also provide useful context to the nature and extent of IT expected in the information system.

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[38] ISA (NZ) 570 (Revised), paragraphs 19–20

Understanding the entity's use of IT

A142. The auditor's understanding of the IT environment may focus on identifying, and understanding the nature and number of, the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system may result from program changes to IT applications, or direct changes to data in databases involved in processing, or storing those transactions or information.

A143. The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through and out the entity's information system.

Obtaining an understanding of the entity's communication (Ref: Para. 25(b))

Scalability

A144. In larger, more complex entities, information the auditor may consider when understanding the entity's communication may come from policy manuals and financial reporting manuals.

A145. In less complex entities, communication may be less structured (e.g., formal manuals may not be used) due to fewer levels of responsibility and management's greater visibility and availability. Regardless of the size of the entity, open communication channels facilitate the reporting of exceptions and acting on them.

Evaluating whether the relevant aspects of the information system support the preparation of the entity's financial statements (Ref: Para. 25(c))

A146. The auditor's evaluation of whether the entity's information system and communication appropriately supports the preparation of the financial statements is based on the understanding obtained in paragraphs 25(a)–(b).

Control Activities (Ref: Para. 26)

Controls in the control activities component

> **Appendix 3**, Paragraphs 20 and 21 set out further considerations relating to control activities.

A147. The control activities component includes controls that are designed to ensure the proper application of policies (which are also controls) in all the other components of the entity's system of internal control, and includes both direct and indirect controls.

> **Example**:
>
> The controls that an entity has established to ensure that its personnel are properly counting and recording the annual physical inventory relate directly to the risks of material misstatement relevant to the existence and completeness assertions for the inventory account balance.

A148. The auditor's identification and evaluation of controls in the control activities component is focused on information processing controls, which are controls applied during the processing of information in the entity's information system that directly address risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information). However, the auditor is not required to identify and evaluate all information processing controls related to the entity's policies that define the flows of transactions and other aspects of the entity's information processing activities for the significant classes of transactions, account balances and disclosures.

A149. There may also be direct controls that exist in the control environment, the entity's risk assessment process or the entity's process to monitor the system of internal control, which may be identified in accordance with paragraph 26. However, the more indirect the relationship between controls that support other controls and the control that is being considered, the less effective that control may be in preventing, or detecting and correcting, related misstatements.

Example:

A sales manager's review of a summary of sales activity for specific stores by region ordinarily is only indirectly related to the risks of material misstatement relevant to the completeness assertion for sales revenue. Accordingly, it may be less effective in addressing those risks than controls more directly related thereto, such as matching shipping documents with billing documents.

A150. Paragraph 26 also requires the auditor to identify and evaluate general IT controls for IT applications and other aspects of the IT environment that the auditor has determined to be subject to risks arising from the use of IT, because general IT controls support the continued effective functioning of information processing controls. A general IT control alone is typically not sufficient to address a risk of material misstatement at the assertion level.

A151. The controls that the auditor is required to identify and evaluate the design, and determine the implementation of, in accordance with paragraph 26 are those:

- Controls which the auditor plans to test the operating effectiveness of in determining the nature, timing and extent of substantive procedures. The evaluation of such controls provides the basis for the auditor's design of test of control procedures in accordance with ISA (NZ) 330. These controls also include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.
- Controls include controls that address significant risks and controls over journal entries. The auditor's identification and evaluation of such controls may also influence the auditor's understanding of the risks of material misstatement, including the identification of additional risks of material misstatement (see paragraph A95). This understanding also provides the basis for the auditor's design of the nature, timing and extent of substantive audit procedures that are responsive to the related assessed risks of material misstatement.

- Other controls that the auditor considers are appropriate to enable the auditor to meet the objectives of paragraph 13 with respect to risks at the assertion level, based on the auditor's professional judgement.

A152. Controls in the control activities component are required to be identified when such controls meet one or more of the criteria included in paragraph 26(a). However, when multiple controls each achieve the same objective, it is unnecessary to identify each of the controls related to such objective.

Types of controls in the control activities component (Ref: Para. 26)

A153. Examples of controls in the control activities component include authorisations and approvals, reconciliations, verifications (such as edit and validation checks or automated calculations), segregation of duties, and physical or logical controls, including those addressing safeguarding of assets.

A154. Controls in the control activities component may also include controls established by management that address risks of material misstatement related to disclosures not being prepared in accordance with the applicable financial reporting framework. Such controls may relate to information included in the financial statements that is obtained from outside of the general and subsidiary ledgers.

A155. Regardless of whether controls are within the IT environment or manual systems, controls may have various objectives and may be applied at various organisational and functional levels.

Scalability (Ref: Para. 26)

A156. Controls in the control activities component for less complex entities are likely to be similar to those in larger entities, but the formality with which they operate may vary. Further, in less complex entities, more controls may be directly applied by management.

Example:

Management's sole authority for granting credit to customers and approving significant purchases can provide strong control over important account balances and transactions.

A157. It may be less practicable to establish segregation of duties in less complex entities that have fewer employees. However, in an owner-managed entity, the owner-manager may be able to exercise more effective oversight through direct involvement than in a larger entity, which may compensate for the generally more limited opportunities for segregation of duties. Although, as also explained in ISA (NZ) 240, domination of management by a single individual can be a potential control deficiency since there is an opportunity for management override of controls.[39]

[39] ISA (NZ) 240, paragraph A28

Controls that address risks of material misstatement at the assertion level (Ref: Para. 26(a))

Controls that address risks that are determined to be a significant risk (Ref: Para. 26(a)(i))

A158. Regardless of whether the auditor plans to test the operating effectiveness of controls that address significant risks, the understanding obtained about management's approach to addressing those risks may provide a basis for the design and performance of substantive procedures responsive to significant risks as required by ISA (NZ) 330.[40] Although risks relating to significant non-routine or judgemental matters are often less likely to be subject to routine controls, management may have other responses intended to deal with such risks. Accordingly, the auditor's understanding of whether the entity has designed and implemented controls for significant risks arising from non-routine or judgemental matters may include whether and how management responds to the risks. Such responses may include:

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

Example:

Where there are one-off events such as the receipt of a notice of a significant lawsuit, consideration of the entity's response may include such matters as whether it has been referred to appropriate experts (such as internal or external legal counsel), whether an assessment has been made of the potential effect, and how it is proposed that the circumstances are to be disclosed in the financial statements.

A159. ISA (NZ) 240[41] requires the auditor to understand controls related to assessed risks of material misstatement due to fraud (which are treated as significant risks), and further explains that it is important for the auditor to obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud.

Controls over journal entries (Ref: Para. 26(a)(ii))

A160. Controls that address risks of material misstatement at the assertion level that are expected to be identified for all audits are controls over journal entries, because the manner in which an entity incorporates information from transaction processing into the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. The extent to which other controls are identified may vary based on the nature of the entity and the auditor's planned approach to further audit procedures.

40 ISA (NZ) 330, paragraphe 21

41 ISA (NZ) 240, paragraphes 28 and A33

> **Example**:
>
> In an audit of a less complex entity, the entity's information system may not be complex and the auditor may not plan to rely on the operating effectiveness of controls. Further, the auditor may not have identified any significant risks or any other risks of material misstatement for which it is necessary for the auditor to evaluate the design of controls and determine that they have been implemented. In such an audit, the auditor may determine that there are no identified controls other than the entity's controls over journal entries.

Automated tools and techniques

A161. In manual general ledger systems, non-standard journal entries may be identified through inspection of ledgers, journals, and supporting documentation. When automated procedures are used to maintain the general ledger and prepare financial statements, such entries may exist only in electronic form and may therefore be more easily identified through the use of automated techniques.

> **Example**:
>
> In the audit of a less complex entity, the auditor may be able to extract a total listing of all journal entries into a simple spreadsheet. It may then be possible for the auditor to sort the journal entries by applying a variety of filters such as currency amount, name of the preparer or reviewer, journal entries that gross up the balance sheet and income statement only, or to view the listing by the date the journal entry was posted to the general ledger, to assist the auditor in designing responses to the risks identified relating to journal entries.

Controls for which the auditor plans to test the operating effectiveness (Ref: Para. 26(a)(iii))

A162. The auditor determines whether there are any risks of material misstatement at the assertion level for which it is not possible to obtain sufficient appropriate audit evidence through substantive procedures alone. The auditor is required, in accordance with ISA (NZ) 330,[42] to design and perform tests of controls that address such risks of material misstatement when substantive procedures alone do not provide sufficient appropriate audit evidence at the assertion level. As a result, when such controls exist that address these risks, they are required to be identified and evaluated.

A163. In other cases, when the auditor plans to take into account the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures in accordance with ISA (NZ) 330, such controls are also required to be identified because ISA (NZ) 330[43] requires the auditor to design and perform tests of those controls.

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[42] ISA (NZ) 330, paragraph 8(b)

[43] ISA (NZ) 330, paragraph 8(a)

Examples:

The auditor may plan to test the operating effectiveness of controls:

- Over routine classes of transactions because such testing may be more effective or efficient for large volumes of homogenous transactions.
- Over the completeness and accuracy of information produced by the entity (e.g., controls over the preparation of system-generated reports), to determine the reliability of that information, when the auditor intends to take into account the operating effectiveness of those controls in designing and performing further audit procedures.
- Relating to operations and compliance objectives when they relate to data the auditor evaluates or uses in applying audit procedures.

A164. The auditor's plans to test the operating effectiveness of controls may also be influenced by the identified risks of material misstatement at the financial statement level. For example, if deficiencies are identified related to the control environment, this may affect the auditor's overall expectations about the operating effectiveness of direct controls.

Other controls that the auditor considers appropriate (Ref: Para. 26(a)(iv))

A165. Other controls that the auditor may consider are appropriate to identify, and evaluate the design and determine the implementation, may include:

- Controls that address risks assessed as higher on the spectrum of inherent risk but have not been determined to be a significant risk;
- Controls related to reconciling detailed records to the general ledger; or
- Complementary user entity controls, if using a service organisation.44

Identifying IT applications and other aspects of the IT environment, risks arising from the use of IT and general IT controls (Ref: Para. 26(b)–(c))

Appendix 5 includes example characteristics of IT applications and other aspects of the IT environment, and guidance related to those characteristics, that may be relevant in identifying IT applications and other aspects of the IT environment subject to risks arising from the use of IT.

Identifying IT applications and other aspects of the IT environment (Ref: Para. 26((b)))

Why the auditor identifies risks arising from the use of IT and general IT controls related to identified IT applications and other aspects of the IT environment

A166. Understanding the risks arising from the use of IT and the general IT controls implemented by the entity to address those risks may affect:

- The auditor's decision about whether to test the operating effectiveness of controls to address risks of material misstatement at the assertion level;

[44] ISA (NZ) 402, *Audit Considerations Relating to an Entity Using a Service Organisation*

> **Example**:
>
> When general IT controls are not designed effectively or appropriately implemented to address risks arising from the use of IT (e.g., controls do not appropriately prevent or detect unauthorised program changes or unauthorised access to IT applications), this may affect the auditor's decision to rely on automated controls within the affected IT applications.

- The auditor's assessment of control risk at the assertion level;

> **Example**:
>
> The ongoing operating effectiveness of an information processing control may depend on certain general IT controls that prevent or detect unauthorised program changes to the IT information processing control (i.e., program change controls over the related IT application). In such circumstances, the expected operating effectiveness (or lack thereof) of the general IT control may affect the auditor's assessment of control risk (e.g., control risk may be higher when such general IT controls are expected to be ineffective or if the auditor does not plan to test the general IT controls).

- The auditor's strategy for testing information produced by the entity that is produced by or involves information from the entity's IT applications;

> **Example**:
>
> When information produced by the entity to be used as audit evidence is produced by IT applications, the auditor may determine to test controls over system-generated reports, including identification and testing of the general IT controls that address risks of inappropriate or unauthorised program changes or direct data changes to the reports.

- The auditor's assessment of inherent risk at the assertion level; or

> **Example**:
>
> When there are significant or extensive programming changes to an IT application to address new or revised reporting requirements of the applicable financial reporting framework, this may be an indicator of the complexity of the new requirements and their effect on the entity's financial statements. When such extensive programming or data changes occur, the IT application is also likely to be subject to risks arising from the use of IT.

- The design of further audit procedures.

> **Example**:
>
> If information processing controls depend on general IT controls, the auditor may determine to test the operating effectiveness of the general IT controls, which will then require the design of tests of controls for such general IT controls. If, in the same circumstances, the auditor determines not to test the operating effectiveness of the general

IT controls, or the general IT controls are expected to be ineffective, the related risks arising from the use of IT may need to be addressed through the design of substantive procedures. However, the risks arising from the use of IT may not be able to be addressed when such risks relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. In such circumstances, the auditor may need to consider the implications for the audit opinion.

Identifying IT applications that are subject to risks arising from the use of IT

A167. For the IT applications relevant to the information system, understanding the nature and complexity of the specific IT processes and general IT controls that the entity has in place may assist the auditor in determining which IT applications the entity is relying upon to accurately process and maintain the integrity of information in the entity's information system. Such IT applications may be subject to risks arising from the use of IT.

A168. Identifying the IT applications that are subject to risks arising from the use of IT involves taking into account controls identified by the auditor because such controls may involve the use of IT or rely on IT. The auditor may focus on whether an IT application includes automated controls that management is relying on and that the auditor has identified, including controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. The auditor may also consider how information is stored and processed in the information system relating to significant classes of transactions, account balances and disclosures and whether management is relying on general IT controls to maintain the integrity of that information.

A169. The controls identified by the auditor may depend on system-generated reports, in which case the IT applications that produce those reports may be subject to risks arising from the use of IT. In other cases, the auditor may not plan to rely on controls over the system-generated reports and plan to directly test the inputs and outputs of such reports, in which case the auditor may not identify the related IT applications as being subject to risks arising from IT.

Scalability

A170. The extent of the auditor's understanding of the IT processes, including the extent to which the entity has general IT controls in place, will vary with the nature and the circumstances of the entity and its IT environment, as well as based on the nature and extent of controls identified by the auditor. The number of IT applications that are subject to risks arising from the use of IT also will vary based on these factors.

Examples:

- An entity that uses commercial software and does not have access to the source code to make any program changes is unlikely to have a process for program changes, but may have a process or procedures to configure the software (e.g., the chart of accounts, reporting parameters or thresholds). In addition, the entity may have a process or procedures to manage access to the application (e.g., a designated individual with administrative access to the commercial software). In such circumstances, the entity is unlikely to have or need formalised general IT controls.

- In contrast, a larger entity may rely on IT to a great extent and the IT environment may involve multiple IT applications and the IT processes to manage the IT environment may be complex (e.g., a dedicated IT department exists that develops and implements program changes and manages access rights), including that the entity has implemented formalised general IT controls over its IT processes.
- When management is not relying on automated controls or general IT controls to process transactions or maintain the data, and the auditor has not identified any automated controls or other information processing controls (or any that depend on general IT controls), the auditor may plan to directly test any information produced by the entity involving IT and may not identify any IT applications that are subject to risks arising from the use of IT.
- When management relies on an IT application to process or maintain data and the volume of data is significant, and management relies upon the IT application to perform automated controls that the auditor has also identified, the IT application is likely to be subject to risks arising from the use of IT.

A171. When an entity has greater complexity in its IT environment, identifying the IT applications and other aspects of the IT environment, determining the related risks arising from the use of IT, and identifying general IT controls is likely to require the involvement of team members with specialised skills in IT. Such involvement is likely to be essential, and may need to be extensive, for complex IT environments.

Identifying other aspects of the IT environment that are subject to risks arising from the use of IT

A172. The other aspects of the IT environment that may be subject to risks arising from the use of IT include the network, operating system and databases, and, in certain circumstances, interfaces between IT applications. Other aspects of the IT environment are generally not identified when the auditor does not identify IT applications that are subject to risks arising from the use of IT. When the auditor has identified IT applications that are subject to risks arising from IT, other aspects of the IT environment (e.g., database, operating system, network) are likely to be identified because such aspects support and interact with the identified IT applications.

Identifying risks arising from the use of IT and general IT controls (Ref: Para. 26(c))

Appendix 6 sets out considerations for understanding general IT controls.

A173. In identifying the risks arising from the use of IT, the auditor may consider the nature of the identified IT application or other aspect of the IT environment and the reasons for it being subject to risks arising from the use of IT. For some identified IT applications or other aspects of the IT environment, the auditor may identify applicable risks arising from the use of IT that relate primarily to unauthorised access or unauthorised program changes, as well as that address risks related to inappropriate data changes (e.g., the risk of inappropriate changes to the data through direct database access or the ability to directly manipulate information).

A174. The extent and nature of the applicable risks arising from the use of IT vary depending on the nature and characteristics of the identified IT applications and other aspects of the IT environment. Applicable IT risks may result when the entity uses external or internal service providers for identified aspects of its IT environment (e.g., outsourcing the hosting of its IT environment to a third party or using a shared service center for central management of IT processes in a group). Applicable risks arising from the use of IT may also be identified related to cybersecurity. It is more likely that there will be more risks arising from the use of IT when the volume or complexity of automated application controls is higher and management is placing greater reliance on those controls for effective processing of transactions or the effective maintenance of the integrity of underlying information.

Evaluating the design, and determining implementation, of identified controls in the control activities component (Ref: Para 26(d))

A175. Evaluating the design of an identified control involves the auditor's consideration of whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements (i.e., the control objective).

A176. The auditor determines the implementation of an identified control by establishing that the control exists and that the entity is using it. There is little point in the auditor assessing the implementation of a control that is not designed effectively. Therefore, the auditor evaluates the design of a control first. An improperly designed control may represent a control deficiency.

A177. Risk assessment procedures to obtain audit evidence about the design and implementation of identified controls in the control activities component may include:

- Enquiring of entity personnel.
- Observing the application of specific controls.
- Inspecting documents and reports.

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

A178. The auditor may expect, based on experience from the previous audit or based on current period risk assessment procedures, that management does not have effectively designed or implemented controls to address a significant risk. In such instances, the procedures performed to address the requirement in paragraph 26(d) may consist of determining that such controls have not been effectively designed or implemented. If the results of the procedures indicate that controls have been newly designed or implemented, the auditor is required to perform the procedures in paragraph 26(b)–(d) on the newly designed or implemented controls.

A179. The auditor may conclude that a control, which is effectively designed and implemented, may be appropriate to test in order to take its operating effectiveness into account in designing substantive procedures. However, when a control is not designed or implemented effectively, there is no benefit in testing it. When the auditor plans to test a control, the information obtained about the extent to which the control addresses the risk(s) of material misstatement is an input to the auditor's control risk assessment at the assertion level.

A180. Evaluating the design and determining the implementation of identified controls in the control activities component is not sufficient to test their operating effectiveness. However, for automated controls, the auditor may plan to test the operating effectiveness of automated controls by identifying and testing general IT controls that provide for the consistent operation of an automated control instead of performing tests of operating effectiveness on the automated controls directly. Obtaining audit evidence about the implementation of a manual control at a point in time does not provide audit evidence about the operating effectiveness of the control at other times during the period under audit. Tests of the operating effectiveness of controls, including tests of indirect controls, are further described in ISA (NZ) 330.[45]

A181. When the auditor does not plan to test the operating effectiveness of identified controls, the auditor's understanding may still assist in the design of the nature, timing and extent of substantive audit procedures that are responsive to the related risks of material misstatement.

> **Example**:
>
> The results of these risk assessment procedures may provide a basis for the auditor's consideration of possible deviations in a population when designing audit samples.

Control Deficiencies Within the Entity's System of Internal Control (Ref: Para. 27)

A182. In performing the evaluations of each of the components of the entity's system of internal control,[46] the auditor may determine that certain of the entity's policies in a component are not appropriate to the nature and circumstances of the entity. Such a determination may be an indicator that assists the auditor in identifying control deficiencies. If the auditor has identified one or more control deficiencies, the auditor may consider the effect of those control deficiencies on the design of further audit procedures in accordance with ISA (NZ) 330.

A183. If the auditor has identified one or more control deficiencies, ISA (NZ) 265[47] requires the auditor to determine whether, individually or in combination, the deficiencies constitute a significant deficiency. The auditor uses professional judgement in determining whether a deficiency represents a significant control deficiency.[48]

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45 ISA (NZ) 330, paragraphs 8–11

46 Paragraphs 21(b), 22(b), 24(c), 25(c) and 26(d)

47 ISA (NZ) 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 8

48 ISA (NZ) 265, paragraphs A6–A7 set out indicators of significant deficiencies, and matters to be considered in determining whether a deficiency, or a combination of deficiencies, in internal control constitute a significant deficiency.

Examples:

Circumstances that may indicate a significant control deficiency exists include matters such as:

- The identification of fraud of any magnitude that involves senior management;
- Identified internal processes that are inadequate relating to the reporting and communication of deficiencies noted by internal audit;
- Previously communicated deficiencies that are not corrected by management in a timely manner;
- Failure by management to respond to significant risks, for example, by not implementing controls over significant risks; and
- The restatement of previously issued financial statements.

Identifying and Assessing the Risks of Material Misstatement (Ref: Para. 28–37)

Why the Auditor Identifies and Assesses the Risks of Material Misstatement

A184. Risks of material misstatement are identified and assessed by the auditor in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

A185. Information gathered by performing risk assessment procedures is used as audit evidence to provide the basis for the identification and assessment of the risks of material misstatement. For example, the audit evidence obtained when evaluating the design of identified controls and determining whether those controls have been implemented in the control activities component, is used as audit evidence to support the risk assessment. Such evidence also provides a basis for the auditor to design overall responses to address the assessed risks of material misstatement at the financial statement level, as well as designing and performing further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level, in accordance with ISA (NZ) 330.

Identifying Risks of Material Misstatement (Ref: Para. 28)

A186. The identification of risks of material misstatement is performed before consideration of any related controls (i.e., the inherent risk), and is based on the auditor's preliminary consideration of misstatements that have a reasonable possibility of both occurring, and being material if they were to occur.[49]

A187. Identifying the risks of material misstatement also provides the basis for the auditor's determination of relevant assertions, which assists the auditor's determination of the significant classes of transactions, account balances and disclosures.

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49 ISA (NZ) 200, paragraph A15a

Assertions

Why the Auditor Uses Assertions

A188. In identifying and assessing the risks of material misstatement, the auditor uses assertions to consider the different types of potential misstatements that may occur. Assertions for which the auditor has identified related risks of material misstatement are relevant assertions.

The Use of Assertions

A189. In identifying and assessing the risks of material misstatement, the auditor may use the categories of assertions as described in paragraph A190(a)–(b) below or may express them differently provided all aspects described below have been covered. The auditor may choose to combine the assertions about classes of transactions and events, and related disclosures, with the assertions about account balances, and related disclosures.

A190. Assertions used by the auditor in considering the different types of potential misstatements that may occur may fall into the following categories:

(a) Assertions about classes of transactions and events, and related disclosures, for the period under audit:

(i) Occurrence—transactions and events that have been recorded or disclosed have occurred, and such transactions and events pertain to the entity.

(ii) Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

(iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.

(iv) Cutoff—transactions and events have been recorded in the correct accounting period.

(v) Classification—transactions and events have been recorded in the proper accounts.

(vi) Presentation—transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

(b) Assertions about account balances, and related disclosures, at the period end:

(i) Existence—assets, liabilities and equity interests exist.

(ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.

(iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

(iv) Accuracy, valuation and allocation—assets, liabilities and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.

(v) Classification—assets, liabilities and equity interests have been recorded in the proper accounts.

(vi) Presentation—assets, liabilities and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

A191. The assertions described in paragraph A190(a)–(b) above, adapted as appropriate, may also be used by the auditor in considering the different types of misstatements that may occur in disclosures not directly related to recorded classes of transactions, events or account balances.

Example:

An example of such a disclosure includes where the entity may be required by the applicable financial reporting framework to describe its exposure to risks arising from financial instruments, including how the risks arise; the objectives, policies and processes for managing the risks; and the methods used to measure the risks.

Considerations Specific to Public Sector Entities

A192. When making assertions about the financial statements of public sector entities, in addition to those assertions set out in paragraph A190(a)–(b), management may often assert that transactions and events have been carried out in accordance with law, regulation or other authority. Such assertions may fall within the scope of the financial statement audit.

Risks of Material Misstatement at the Financial Statement Level (Ref: Para. 28(a) and 30)

Why the Auditor Identifies and Assesses Risks of Material Misstatement at the Financial Statement Level

A193. The auditor identifies risks of material misstatement at the financial statement level to determine whether the risks have a pervasive effect on the financial statements, and would therefore require an overall response in accordance with ISA (NZ) 330.[50]

A194. In addition, risks of material misstatement at the financial statement level may also affect individual assertions, and identifying these risks may assist the auditor in assessing risks of material misstatement at the assertion level, and in designing further audit procedures to address the identified risks.

[50] ISA (NZ) 330, paragraph 5

Identifying and Assessing Risks of Material Misstatement at the Financial Statement Level

A195. 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 level (e.g., risk of management override of controls). Rather, they represent circumstances that may pervasively increase the risks of material misstatement at the assertion level. The auditor's evaluation of whether risks identified relate pervasively to the financial statements supports the auditor's assessment of the risks of material misstatement at the financial statement level. In other cases, a number of assertions may also be identified as susceptible to the risk, and may therefore affect the auditor's risk identification and assessment of risks of material misstatement at the assertion level.

> **Example**:
>
> The entity faces operating losses and liquidity issues and is reliant on funding that has not yet been secured. In such a circumstance, the auditor may determine that the going concern basis of accounting gives rise to a risk of material misstatement at the financial statement level. In this situation, the accounting framework may need to be applied using a liquidation basis, which would likely affect all assertions pervasively.

A196. The auditor's identification and assessment of risks of material misstatement at the financial statement level is influenced by the auditor's understanding of the entity's system of internal control, in particular the auditor's understanding of the control environment, the entity's risk assessment process and the entity's process to monitor the system of internal control, and:

- The outcome of the related evaluations required by paragraphs 21(b), 22(b), 24(c) and 25(c); and
- Any control deficiencies identified in accordance with paragraph 27.

In particular, risks at the financial statement level may arise from deficiencies in the control environment or from external events or conditions such as declining economic conditions.

A197. Risks of material misstatement due to fraud may be particularly relevant to the auditor's consideration of the risks of material misstatement at the financial statement level.

> **Example**:
>
> The auditor understands from enquiries of management that the entity's financial statements are to be used in discussions with lenders in order to secure further financing to maintain working capital. The auditor may therefore determine that there is a greater susceptibility to misstatement due to fraud risk factors that affect inherent risk (i.e., the susceptibility of the financial statements to material misstatement because of the risk of fraudulent financial reporting, such as overstatement of assets and revenue and under-statement of liabilities and expenses to ensure that financing will be obtained).

A198. The auditor's understanding, including the related evaluations, of the control environment and other components of the system of internal control may raise doubts about the auditor's ability to obtain audit evidence on which to base the audit opinion or be cause for withdrawal from the engagement where withdrawal is possible under applicable law or regulation.

> **Examples**:
>
> - As a result of evaluating the entity's control environment, the auditor has concerns about the integrity of the entity's management, which may be so serious as to cause the auditor to conclude that the risk of intentional misrepresentation by management in the financial statements is such that an audit cannot be conducted.
> - As a result of evaluating the entity's information system and communication, the auditor determines that significant changes in the IT environment have been poorly managed, with little oversight from management and those charged with governance. The auditor concludes that there are significant concerns about the condition and reliability of the entity's accounting records. In such circumstances, the auditor may determine that it is unlikely that sufficient appropriate audit evidence will be available to support an unmodified opinion on the financial statements.

A199. ISA (NZ) 705 (Revised)[51] establishes requirements and provides guidance in determining whether there is a need for the auditor to express a qualified opinion or disclaim an opinion or, as may be required in some cases, to withdraw from the engagement where withdrawal is possible under applicable law or regulation.

Considerations Specific to Public Sector Entities

A200. For public sector entities, the identification of risks at the financial statement level may include consideration of matters related to the political climate, public interest and programme sensitivity.

Risks of Material Misstatement at the Assertion Level (Ref: Para. 28(b))

> **Appendix 2** sets out examples, in the context of inherent risk factors, of events or conditions that may indicate susceptibility to misstatement that may be material.

A201. Risks of material misstatements that do not relate pervasively to the financial statements are risks of material misstatement at the assertion level.

Relevant Assertions and Significant Classes of Transactions, Account Balances and Disclosures (Ref: Para. 29)

Why Relevant Assertions and Significant Classes of Transactions, Account Balances and Disclosures Are Determined

A202. Determining relevant assertions and the significant classes of transactions, account balances and disclosures provides the basis for the scope of the auditor's understanding

[51] ISA (NZ) 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

of the entity's information system required to be obtained in accordance with paragraph 25(a). This understanding may further assist the auditor in identifying and assessing risks of material misstatement (see A86).

Automated Tools and Techniques

A203. The auditor may use automated techniques to assist in the identification of significant classes of transactions, account balances and disclosures.

Examples:

- An entire population of transactions may be analysed using automated tools and techniques to understand their nature, source, size and volume. By applying automated techniques, the auditor may, for example, identify that an account with a zero balance at period end was comprised of numerous offsetting transactions and journal entries occurring during the period, indicating that the account balance or class of transactions may be significant (e.g., a payroll clearing account). This same payroll clearing account may also identify expense reimbursements to management (and other employees), which could be a significant disclosure due to these payments being made to related parties.
- By analysing the flows of an entire population of revenue transactions, the auditor may more easily identify a significant class of transactions that had not previously been identified.

Disclosures that May Be Significant

A204. Significant disclosures include both quantitative and qualitative disclosures for which there is one or more relevant assertions. Examples of disclosures that have qualitative aspects and that may have relevant assertions and may therefore be considered significant by the auditor include disclosures about:

- Liquidity and debt covenants of an entity in financial distress.
- Events or circumstances that have led to the recognition of an impairment loss.
- Key sources of estimation uncertainty, including assumptions about the future.
- The nature of a change in accounting policy, and other relevant disclosures required by the applicable financial reporting framework, where, for example, new financial reporting requirements are expected to have a significant impact on the financial position and financial performance of the entity.
- Share-based payment arrangements, including information about how any amounts recognised were determined, and other relevant disclosures.
- Related parties, and related party transactions.
- Sensitivity analysis, including the effects of changes in assumptions used in the entity's valuation techniques intended to enable users to understand the underlying measurement uncertainty of a recorded or disclosed amount.

Assessing Risks of Material Misstatement at the Assertion Level

Assessing Inherent Risk (Ref: Para. 31–33)

Assessing the likelihood and magnitude of misstatement (Ref: Para: 31)

Why the auditor assesses likelihood and magnitude of misstatement

A205. The auditor assesses the likelihood and magnitude of misstatement for identified risks of material misstatement because the significance of the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement were the misstatement to occur determines where on the spectrum of inherent risk the identified risk is assessed, which informs the auditor's design of further audit procedures to address the risk.

A206. Assessing the inherent risk of identified risks of material misstatement also assists the auditor in determining significant risks. The auditor determines significant risks because specific responses to significant risks are required in accordance with ISA (NZ) 330 and other ISAs (NZ).

A207. Inherent risk factors influence the auditor's assessment of the likelihood and magnitude of misstatement for the identified risks of material misstatement at the assertion level. The greater the degree to which a class of transactions, account balance or disclosure is susceptible to material misstatement, the higher the inherent risk assessment is likely to be. Considering the degree to which inherent risk factors affect the susceptibility of an assertion to misstatement assists the auditor in appropriately assessing inherent risk for risks of material misstatement at the assertion level and in designing a more precise response to such a risk.

Spectrum of inherent risk

A208. In assessing inherent risk, the auditor uses professional judgement in determining the significance of the combination of the likelihood and magnitude of a misstatement.

A209. The assessed inherent risk relating to a particular risk of material misstatement at the assertion level represents a judgement within a range, from lower to higher, on the spectrum of inherent risk. The judgement about where in the range inherent risk is assessed may vary based on the nature, size and complexity of the entity, and takes into account the assessed likelihood and magnitude of the misstatement and inherent risk factors.

A210. In considering the likelihood of a misstatement, the auditor considers the possibility that a misstatement may occur, based on consideration of the inherent risk factors.

A211. In considering the magnitude of a misstatement, the auditor considers the qualitative and quantitative aspects of the possible misstatement (i.e., misstatements in assertions about classes of transactions, account balances or disclosures may be judged to be material due to size, nature or circumstances).

A212. The auditor uses the significance of the combination of the likelihood and magnitude of a possible misstatement in determining where on the spectrum of inherent risk (i.e., the range) inherent risk is assessed. The higher the combination of likelihood and magnitude, the higher the assessment of inherent risk; the lower the combination of likelihood and magnitude, the lower the assessment of inherent risk.

A213. For a risk to be assessed as higher on the spectrum of inherent risk, it does not mean that both the magnitude and likelihood need to be assessed as high. Rather, it is the intersection of the magnitude and likelihood of the material misstatement on the spectrum of inherent risk that will determine whether the assessed inherent risk is higher or lower on the spectrum of inherent risk. A higher inherent risk assessment may also arise from different combinations of likelihood and magnitude, for example a higher inherent risk assessment could result from a lower likelihood but a very high magnitude.

A214. In order to develop appropriate strategies for responding to risks of material misstatement, the auditor may designate risks of material misstatement within categories along the spectrum of inherent risk, based on their assessment of inherent risk. These categories may be described in different ways. Regardless of the method of categorisation used, the auditor's assessment of inherent risk is appropriate when the design and implementation of further audit procedures to address the identified risks of material misstatement at the assertion level is appropriately responsive to the assessment of inherent risk and the reasons for that assessment.

Pervasive Risks of Material Misstatement at the Assertion Level (Ref: Para 31(b))

A215. In assessing the identified risks of material misstatement at the assertion level, the auditor may conclude that some risks of material misstatement relate more pervasively to the financial statements as a whole and potentially affect many assertions, in which case the auditor may update the identification of risks of material misstatement at the financial statement level.

A216. In circumstances in which risks of material misstatement are identified as financial statement level risks due to their pervasive effect on a number of assertions, and are identifiable with specific assertions, the auditor is required to take into account those risks when assessing inherent risk for risks of material misstatement at the assertion level.

Considerations Specific to Public Sector Entities

A217. In exercising professional judgement as to the assessment of the risk of material misstatement, public sector auditors may consider the complexity of the regulations and directives, and the risks of non-compliance with authorities.

Significant Risks (Ref: Para. 32)

Why significant risks are determined and the implications for the audit

A218. The determination of significant risks allows for the auditor to focus more attention on those risks that are on the upper end of the spectrum of inherent risk, through the performance of certain required responses, including:

- Controls that address significant risks are required to be identified in accordance with paragraph 26(a)(i), with a requirement to evaluate whether the control has been designed effectively and implemented in accordance with paragraph 26(d).

- ISA (NZ) 330 requires controls that address significant risks to be tested in the current period (when the auditor intends to rely on the operating effectiveness of such controls) and substantive procedures to be planned and performed that are specifically responsive to the identified significant risk.[52]
- ISA (NZ) 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of risk.[53]
- ISA (NZ) 260 (Revised) requires communicating with those charged with governance about the significant risks identified by the auditor.[54]
- ISA (NZ) 701 requires the auditor to take into account significant risks when determining those matters that required significant auditor attention, which are matters that may be key audit matters.[55]
- Timely review of audit documentation by the engagement partner at the appropriate stages during the audit allows significant matters, including significant risks, to be resolved on a timely basis to the engagement partner's satisfaction on or before the date of the auditor's report.[56]
- ISA (NZ) 600 requires more involvement by the group engagement partner if the significant risk relates to a component in a group audit and for the group engagement team to direct the work required at the component by the component auditor.[57]

Determining significant risks

A219. In determining significant risks, the auditor may first identify those assessed risks of material misstatement that have been assessed higher on the spectrum of inherent risk to form the basis for considering which risks may be close to the upper end. Being close to the upper end of the spectrum of inherent risk will differ from entity to entity, and will not necessarily be the same for an entity period on period. It may depend on the nature and circumstances of the entity for which the risk is being assessed.

A220. The determination of which of the assessed risks of material misstatement are close to the upper end of the spectrum of inherent risk, and are therefore significant risks, is a matter of professional judgement, unless the risk is of a type specified to be treated as a significant risk in accordance with the requirements of another ISA (NZ). ISA (NZ) 240 provides further requirements and guidance in relation to the identification and assessment of the risks of material misstatement due to fraud.[58]

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52 ISA (NZ) 330, paragraphs 15 and 21

53 ISA (NZ) 330, paragraph 7(b)

54 ISA (NZ) 260 (Revised), paragraph 15

55 ISA (NZ) 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, paragraph 9

56 ISA (NZ) 220, paragraphs 17 and A19

57 ISA (NZ) 600, paragraphs 30 and 31

58 ISA (NZ) 240, paragraphs 26–28

> **Example**:
>
> - Cash at a supermarket retailer would ordinarily be determined to be a high likelihood of possible misstatement (due to the risk of cash being misappropriated), however the magnitude would typically be very low (due to the low levels of physical cash handled in the stores). The combination of these two factors on the spectrum of inherent risk would be unlikely to result in the existence of cash being determined to be a significant risk.
> - An entity is in negotiations to sell a business segment. The auditor considers the effect on goodwill impairment, and may determine there is a higher likelihood of possible misstatement and a higher magnitude due to the impact of inherent risk factors of subjectivity, uncertainty and susceptibility to management bias or other fraud risk factors. This may result in goodwill impairment being determined to be a significant risk.

A221. The auditor also takes into the account the relative effects of inherent risk factors when assessing inherent risk. The lower the effect of inherent risk factors, the lower the assessed risk is likely to be. Risks of material misstatement that may be assessed as having higher inherent risk and may therefore be determined to be a significant risk, may arise from matters such as the following:

- Transactions for which there are multiple acceptable accounting treatments such that subjectivity is involved.
- Accounting estimates that have high estimation uncertainty or complex models.
- Complexity in data collection and processing to support account balances.
- Account balances or quantitative disclosures that involve complex calculations.
- Accounting principles that may be subject to differing interpretation.
- Changes in the entity's business that involve changes in accounting, for example, mergers and acquisitions.

Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence (Ref: Para. 33)

Why risks for which substantive procedures alone do not provide sufficient appropriate audit evidence are required to be identified

A222. Due to the nature of a risk of material misstatement, and the control activities that address that risk, in some circumstances the only way to obtain sufficient appropriate audit evidence is to test the operating effectiveness of controls. Accordingly, there is a requirement for the auditor to identify any such risks because of the implications for the design and performance of further audit procedures in accordance with ISA (NZ) 330 to address risks of material misstatement at the assertion level.

A223. Paragraph 26(a)(iii) also requires the identification of controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence because the auditor is required, in accordance with ISA (NZ) 330,[59] to design and perform tests of such controls.

Determining risks for which substantive procedures alone do not provide sufficient appropriate audit evidence

A224. Where routine business transactions are subject to highly automated processing with little or no manual intervention, it may not be possible to perform only substantive procedures in relation to the risk. This may be the case in circumstances where a significant amount of an entity's information is initiated, recorded, processed, or reported only in electronic form such as in an information system that involves a high degree of integration across its IT applications. In such cases:

- Audit evidence may be available only in electronic form, and its sufficiency and appropriateness usually depend on the effectiveness of controls over its accuracy and completeness.
- The potential for improper initiation or alteration of information to occur and not be detected may be greater if appropriate controls are not operating effectively.

> **Example**:
>
> It is typically not possible to obtain sufficient appropriate audit evidence relating to revenue for a telecommunications entity based on substantive procedures alone. This is because the evidence of call or data activity does not exist in a form that is observable. Instead, substantial controls testing is typically performed to determine that the origination and completion of calls, and data activity is correctly captured (e.g., minutes of a call or volume of a download) and recorded correctly in the entity's billing system.

A225. ISA (NZ) 540 (Revised) provides further guidance related to accounting estimates about risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.[60] In relation to accounting estimates this may not be limited to automated processing, but may also be applicable to complex models.

Assessing Control Risk (Ref: Para. 34)

A226. The auditor's plans to test the operating effectiveness of controls is based on the expectation that controls are operating effectively, and this will form the basis of the auditor's assessment of control risk. The initial expectation of the operating effectiveness of controls is based on the auditor's evaluation of the design, and the determination of implementation, of the identified controls in the control activities component. Once the auditor has tested the operating effectiveness of the controls in accordance with ISA (NZ) 330, the auditor will be able to confirm the initial expectation about the operating effectiveness of controls. If the controls are not operating effectively as expected, then the auditor will need to revise the control risk assessment in accordance with paragraph 37.

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59 ISA (NZ) 330, paragraph 8

60 ISA (NZ) 540 (Revised), paragraphs A87–A89

A227. The auditor's assessment of control risk may be performed in different ways depending on preferred audit techniques or methodologies, and may be expressed in different ways.

A228. If the auditor plans to test the operating effectiveness of controls, it may be necessary to test a combination of controls to confirm the auditor's expectation that the controls are operating effectively. The auditor may plan to test both direct and indirect controls, including general IT controls, and, if so, take into account the combined expected effect of the controls when assessing control risk. To the extent that the control to be tested does not fully address the assessed inherent risk , the auditor determines the implications on the design of further audit procedures to reduce audit risk to an acceptably low level.

A229. When the auditor plans to test the operating effectiveness of an automated control, the auditor may also plan to test the operating effectiveness of the relevant general IT controls that support the continued functioning of that automated control to address the risks arising from the use of IT, and to provide a basis for the auditor's expectation that the automated control operated effectively throughout the period. When the auditor expects related general IT controls to be ineffective, this determination may affect the auditor's assessment of control risk at the assertion level and the auditor's further audit procedures may need to include substantive procedures to address the applicable risks arising from the use of IT. Further guidance about the procedures that the auditor may perform in these circumstances is provided in ISA (NZ) 330.[61]

Evaluating the Audit Evidence Obtained from the Risk Assessment Procedures (Ref: Para 35)

Why the Auditor Evaluates the Audit Evidence from the Risk Assessment Procedures

A230. Audit evidence obtained from performing risk assessment procedures provides the basis for the identification and assessment of the risks of material misstatement. This provides the basis for the auditor's design of the nature, timing and extent of further audit procedures responsive to the assessed risks of material misstatement, at the assertion level, in accordance with ISA (NZ) 330. Accordingly, the audit evidence obtained from the risk assessment procedures provides a basis for the identification and assessment of risks of material misstatement whether due to fraud or error, at the financial statement and assertion levels.

The Evaluation of the Audit Evidence

A231. Audit evidence from risk assessment procedures comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.[62]

Professional Scepticism

A232. In evaluating the audit evidence from the risk assessment procedures, the auditor considers whether sufficient understanding about the entity and its environment, the applicable financial reporting framework and the entity's system of internal control has been obtained to be able to identify the risks of material misstatement, as well as whether

61 ISA (NZ) 330, paragraphs A29–A30

62 ISA (NZ) 500, paragraph A1

there is any evidence that is contradictory that may indicate a risk of material misstatement.

Classes of Transactions, Account Balances and Disclosures that Are Not Significant, but Which Are Material (Ref: Para. 36)

A233. As explained in ISA (NZ) 320,[63] materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances and disclosures. The auditor's determination of materiality is a matter of professional judgement, and is affected by the auditor's perception of the financial information needs of users of the financial statements.[64] For the purpose of this ISA (NZ) and paragraph 18 of ISA (NZ) 330, classes of transactions, account balances or disclosures are material if omitting, misstating or obscuring information about them could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole.

A234. There may be classes of transactions, account balances or disclosures that are material but have not been determined to be significant classes of transactions, account balances or disclosures (i.e., there are no relevant assertions identified).

Example:

The entity may have a disclosure about executive compensation for which the auditor has not identified a risk of material misstatement. However, the auditor may determine that this disclosure is material based on the considerations in paragraph A233.

A235. Audit procedures to address classes of transactions, account balances or disclosures that are material but are not determined to be significant are addressed in ISA (NZ) 330.[65] When a class of transactions, account balance or disclosure is determined to be significant as required by paragraph 29, the class of transactions, account balance or disclosure is also a material class of transactions, account balance or disclosure for the purposes of paragraph 18 of ISA (NZ) 330.

Revision of Risk Assessment (Ref: Para. 37)

A236. During the audit, new or other information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based.

[63] ISA (NZ) 320, paragraph A1

[64] ISA (NZ) 320, paragraph 4

[65] ISA (NZ) 330, paragraph 18

Example:

The entity's risk assessment may be based on an expectation that certain controls are operating effectively. In performing tests of those controls, the auditor may obtain audit evidence that they were not operating effectively at relevant times during the audit. Similarly, in performing substantive procedures the auditor may detect misstatements in amounts or frequency greater than is consistent with the auditor's risk assessments. In such circumstances, the risk assessment may not appropriately reflect the true circumstances of the entity and the further planned audit procedures may not be effective in detecting material misstatements. Paragraphs 16 and 17 of ISA (NZ) 330 provide further guidance about evaluating the operating effectiveness of controls.

Documentation (Ref: Para. 38)

A237. For recurring audits, certain documentation may be carried forward, updated as necessary to reflect changes in the entity's business or processes.

A238. ISA (NZ) 230 notes that, among other considerations, although there may be no single way in which the auditor's exercise of professional scepticism is documented, the audit documentation may nevertheless provide evidence of the auditor's exercise of professional scepticism.[66] For example, when the audit evidence obtained from risk assessment procedures includes evidence that both corroborates and contradicts management's assertions, the documentation may include how the auditor evaluated that evidence, including the professional judgements made in evaluating whether the audit evidence provides an appropriate basis for the auditor's identification and assessment of the risks of material misstatement. Examples of other requirements in this ISA (NZ) for which documentation may provide evidence of the exercise of professional scepticism by the auditor include:

- Paragraph 13, which requires the auditor to design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may corroborate the existence of risks or towards excluding audit evidence that may contradict the existence of risks;
- Paragraph 17, which requires a discussion among key engagement team members of the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement;
- Paragraphs 19(b) and 20, which require the auditor to obtain an understanding of the reasons for any changes to the entity's accounting policies and to evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework;
- Paragraphs 21(b), 22(b), 23(b), 24(c), 25(c), 26(d) and 27, which require the auditor to evaluate, based on the required understanding obtained, whether the components of the entity's system of internal control are appropriate to the entity's circumstances

[66] ISA (NZ) 230, paragraph A7

considering the nature and complexity of the entity, and to determine whether one of more control deficiencies have been identified;

- Paragraph 35, which requires the auditor to take into account all audit evidence obtained from the risk assessment procedures, whether corroborative or contradictory to assertions made by management, and to evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement; and
- Paragraph 36, which requires the auditor to evaluate, when applicable, whether the auditor's determination that there are no risks of material misstatement for a material class of transactions, account balance or disclosure remains appropriate.

Scalability

A239. The manner in which the requirements of paragraph 38 are documented is for the auditor to determine using professional judgement.

A240. More detailed documentation, that is sufficient to enable an experienced auditor, having no previous experience with the audit, to understand the nature, timing and extent of the audit procedures performed, may be required to support the rationale for difficult judgements made.

A241. For the audits of less complex entities, the form and extent of documentation may be simple and relatively brief. The form and extent of the auditor's documentation is influenced by the nature, size and complexity of the entity and its system of internal control, availability of information from the entity and the audit methodology and technology used in the course of the audit. It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it. Key elements[67] of understanding documented by the auditor may include those on which the auditor based the assessment of the risks of material misstatement. However, the auditor is not required to document every inherent risk factor that was taken into account in identifying and assessing the risks of material misstatement at the assertion level.

Example:

In audits of less complex entities audit documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan.[68] Similarly, for example, the results of the risk assessment may be documented separately, or may be documented as part of the auditor's documentation of further audit procedures.[69]

[67] ISA (NZ) 230, paragraph 8

[68] ISA (NZ) 300, *Planning an Audit of Financial Statements*, paragraphs 7, 9 and A11

[69] ISA (NZ) 330, paragraph 28

Appendix 1

(Ref: Para. A61–A67)

Considerations for Understanding the Entity and its Business Model

This appendix explains the objectives and scope of the entity's business model and provides examples of matters that the auditor may consider in understanding the activities of the entity that may be included in the business model. The auditor's understanding of the entity's business model, and how it is affected by its business strategy and business objectives, may assist the auditor in identifying business risks that may have an effect on the financial statements. In addition, this may assist the auditor in identifying risks of material misstatement.

Objectives and Scope of an Entity's Business Model

1. An entity's business model describes how an entity considers, for example its organisational structure, operations or scope of activities, business lines (including competitors and customers thereof), processes, growth opportunities, globalisation, regulatory requirements and technologies. The entity's business model describes how the entity creates, preserves and captures financial or broader value, for its stakeholders.

2. Strategies are the approaches by which management plans to achieve the entity's objectives, including how the entity plans to address the risks and opportunities that it faces. An entity's strategies are changed over time by management, to respond to changes in its objectives and in the internal and external circumstances in which it operates.

3. A description of a business model typically includes:

    - The scope of the entity's activities, and why it does them.
    - The entity's structure and scale of its operations.
    - The markets or geographical or demographic spheres, and parts of the value chain, in which it operates, how it engages with those markets or spheres (main products, customer segments and distribution methods), and the basis on which it competes.
    - The entity's business or operating processes (e.g., investment, financing and operating processes) employed in performing its activities, focusing on those parts of the business processes that are important in creating, preserving or capturing value.
    - The resources (e.g., financial, human, intellectual, environmental and technological) and other inputs and relationships (e.g., customers, competitors, suppliers and employees) that are necessary or important to its success.
    - How the entity's business model integrates the use of IT in its interactions with customers, suppliers, lenders and other stakeholders through IT interfaces and other technologies.

4. A business risk may have an immediate consequence for the risk of material misstatement for classes of transactions, account balances, and disclosures at the assertion level or the financial statement level. For example, the business risk arising from a significant fall in real estate market values may increase the risk of material misstatement associated with the valuation assertion for a lender of medium-term real estate backed loans. However, the same

risk, particularly in combination with a severe economic downturn that concurrently increases the underlying risk of lifetime credit losses on its loans, may also have a longer-term consequence. The resulting net exposure to credit losses may cast significant doubt on the entity's ability to continue as a going concern. If so, this could have implications for management's, and the auditor's, conclusion as to the appropriateness of the entity's use of the going concern basis of accounting, and determination as to whether a material uncertainty exists. Whether a business risk may result in a risk of material misstatement is, therefore, considered in light of the entity's circumstances. Examples of events and conditions that may give rise to the existence of risks of material misstatement are indicated in **Appendix 2**.

Activities of the Entity

5. Examples of matters that the auditor may consider when obtaining an understanding of the activities of the entity (included in the entity's business model) include:

   (a) Business operations such as:

   - Nature of revenue sources, products or services, and markets, including involvement in electronic commerce such as Internet sales and marketing activities.
   - Conduct of operations (for example, stages and methods of production, or activities exposed to environmental risks).
   - Alliances, joint ventures, and outsourcing activities.
   - Geographic dispersion and industry segmentation.
   - Location of production facilities, warehouses, and offices, and location and quantities of inventories.
   - Key customers and important suppliers of goods and services, employment arrangements (including the existence of union contracts, pension and other post-employment benefits, share option or incentive bonus arrangements, and government regulation related to employment matters).
   - Research and development activities and expenditures.
   - Transactions with related parties.

   (b) Investments and investment activities such as:

   - Planned or recently executed acquisitions or divestitures.
   - Investments and dispositions of securities and loans.
   - Capital investment activities.
   - Investments in non-consolidated entities, including non-controlled partnerships, joint ventures and non-controlled special-purpose entities.

   (c) Financing and financing activities such as:

   - Ownership structure of major subsidiaries and associated entities, including consolidated and non-consolidated structures.

- Debt structure and related terms, including off-balance-sheet financing arrangements and leasing arrangements.
- Beneficial owners (for example, local, foreign, business reputation and experience) and related parties.
- Use of derivative financial instruments.

Nature of Special-Purpose Entities

6. A special-purpose entity (sometimes referred to as a special-purpose vehicle) is an entity that is generally established for a narrow and well-defined purpose, such as to effect a lease or a securitisation of financial assets, or to carry out research and development activities. It may take the form of a corporation, trust, partnership or unincorporated entity. The entity on behalf of which the special-purpose entity has been created may often transfer assets to the latter (for example, as part of a derecognition transaction involving financial assets), obtain the right to use the latter's assets, or perform services for the latter, while other parties may provide the funding to the latter. As ISA (NZ) 550 indicates, in some circumstances, a special-purpose entity may be a related party of the entity.[70]

7. Financial reporting frameworks often specify detailed conditions that are deemed to amount to control, or circumstances under which the special-purpose entity should be considered for consolidation. The interpretation of the requirements of such frameworks often demands a detailed knowledge of the relevant agreements involving the special-purpose entity.

[70] ISA (NZ) 550, paragraph A7

Appendix 2

(Ref: Para. 12(f), 19(c), A7–A8, A85–A89)

Understanding Inherent Risk Factors

This appendix provides further explanation about the inherent risk factors, as well as matters that the auditor may consider in understanding and applying the inherent risk factors in identifying and assessing the risks of material misstatement at the assertion level.

The Inherent Risk Factors

1. Inherent risk factors are characteristics of events or conditions that affect susceptibility of an assertion about a class of transactions, account balance or disclosure, to misstatement, whether due to fraud or error, and before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors[71] insofar as they affect inherent risk. In obtaining the understanding of the entity and its environment, and the applicable financial reporting framework and the entity's accounting policies, in accordance with paragraphs 19(a)–(b), the auditor also understands how inherent risk factors affect susceptibility of assertions to misstatement in the preparation of the financial statements.

2. Inherent risk factors relating to the preparation of information required by the applicable financial reporting framework (referred to in this paragraph as "required information") include:

   - *Complexity*—arises either from the nature of the information or in the way that the required information is prepared, including when such preparation processes are more inherently difficult to apply. For example, complexity may arise:
     - In calculating supplier rebate provisions because it may be necessary to take into account different commercial terms with many different suppliers, or many interrelated commercial terms that are all relevant in calculating the rebates due; or
     - When there are many potential data sources, with different characteristics used in making an accounting estimate, the processing of that data involves many inter-related steps, and the data is therefore inherently more difficult to identify, capture, access, understand or process.
   - *Subjectivity*—arises from inherent limitations in the ability to prepare required information in an objective manner, due to limitations in the availability of knowledge or information, such that management may need to make an election or subjective judgement about the appropriate approach to take and about the resulting information to include in the financial statements. Because of different approaches to preparing the required information, different outcomes could result from appropriately applying the requirements of the applicable financial reporting framework. As limitations in knowledge or data increase, the subjectivity in the judgements that could be made by

[71] ISA (NZ) 240, paragraphs A24–A27

reasonably knowledgeable and independent individuals, and the diversity in possible outcomes of those judgements, will also increase.

- *Change*—results from events or conditions that, over time, affect the entity's business or the economic, accounting, regulatory, industry or other aspects of the environment in which it operates, when the effects of those events or conditions are reflected in the required information. Such events or conditions may occur during, or between, financial reporting periods. For example, change may result from developments in the requirements of the applicable financial reporting framework, or in the entity and its business model, or in the environment in which the entity operates. Such change may affect management's assumptions and judgements, including as they relate to management's selection of accounting policies or how accounting estimates are made or related disclosures are determined.
- *Uncertainty*—arises when the required information cannot be prepared based only on sufficiently precise and comprehensive data that is verifiable through direct observation. In these circumstances, an approach may need to be taken that applies the available knowledge to prepare the information using sufficiently precise and comprehensive observable data, to the extent available, and reasonable assumptions supported by the most appropriate available data, when it is not. Constraints on the availability of knowledge or data, which are not within the control of management (subject to cost constraints where applicable) are sources of uncertainty and their effect on the preparation of the required information cannot be eliminated. For example, estimation uncertainty arises when the required monetary amount cannot be determined with precision and the outcome of the estimate is not known before the date the financial statements are finalised.
- *Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk* —susceptibility to management bias results from conditions that create susceptibility to intentional or unintentional failure by management to maintain neutrality in preparing the information. Management bias is often associated with certain conditions that have the potential to give rise to management not maintaining neutrality in exercising judgement (indicators of potential management bias), which could lead to a material misstatement of the information that would be fraudulent if intentional. Such indicators include incentives or pressures insofar as they affect inherent risk (for example, as a result of motivation to achieve a desired result, such as a desired profit target or capital ratio), and opportunity, not to maintain neutrality. Factors relevant to the susceptibility to misstatement due to fraud in the form of fraudulent financial reporting or misappropriation of assets are described in paragraphs A1 to A5 of ISA (NZ) 240.

3. When complexity is an inherent risk factor, there may be an inherent need for more complex processes in preparing the information, and such processes may be inherently more difficult to apply. As a result, applying them may require specialised skills or knowledge, and may require the use of a management's expert.

4. When management judgement is more subjective, the susceptibility to misstatement due to management bias, whether unintentional or intentional, may also increase. For example, significant management judgement may be involved in making accounting estimates that

have been identified as having high estimation uncertainty, and conclusions regarding methods, data and assumptions may reflect unintentional or intentional management bias.

Examples of Events or Conditions that May Give Rise to the Existence of Risks of Material Misstatement

5. The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement in the financial statements, at the financial statement level or the assertion level. The examples provided by inherent risk factor cover a broad range of events and conditions; however, not all events and conditions are relevant to every audit engagement and the list of examples is not necessarily complete. The events and conditions have been categorised by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among inherent risk factors, the example events and conditions also are likely to be subject to, or affected by, other inherent risk factors to varying degrees.

Relevant Inherent Risk Factor:	Examples of Events or Conditions That May Indicate the Existence of Risks of Material Misstatement at the Assertion Level:
Complexity	Regulatory: • Operations that are subject to a high degree of complex regulation. Business model: • The existence of complex alliances and joint ventures. Applicable financial reporting framework: • Accounting measurements that involve complex processes. Transactions: • Use of off-balance sheet finance, special-purpose entities, and other complex financing arrangements.
Subjectivity	Applicable financial reporting framework: • A wide range of possible measurement criteria of an accounting estimate. For example, management's recognition of depreciation or construction income and expenses. • Management's selection of a valuation technique or model for a non-current asset, such as investment properties.
Change	Economic conditions: • Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies. Markets:

Relevant Inherent Risk Factor:	Examples of Events or Conditions That May Indicate the Existence of Risks of Material Misstatement at the Assertion Level:
	• Operations exposed to volatile markets, for example, futures trading. Customer loss: • Going concern and liquidity issues including loss of significant customers. Industry model: • Changes in the industry in which the entity operates. Business model: • Changes in the supply chain. • Developing or offering new products or services, or moving into new lines of business. Geography: • Expanding into new locations. Entity structure: • Changes in the entity such as large acquisitions or reorganisations or other unusual events. • Entities or business segments likely to be sold. Human resources competence: • Changes in key personnel including departure of key executives. IT: • Changes in the IT environment. • Installation of significant new IT systems related to financial reporting. Applicable financial reporting framework: • Application of new accounting pronouncements. Capital: • New constraints on the availability of capital and credit. Regulatory: • Inception of investigations into the entity's operations or financial results by regulatory or government bodies. • Impact of new legislation related to environmental protection.

Relevant Inherent Risk Factor:	Examples of Events or Conditions That May Indicate the Existence of Risks of Material Misstatement at the Assertion Level:
Uncertainty	Reporting: • Events or transactions that involve significant measurement uncertainty, including accounting estimates, and related disclosures. • Pending litigation and contingent liabilities, for example, sales warranties, financial guarantees and environmental remediation.
Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk	Reporting: • Opportunities for management and employees to engage in fraudulent financial reporting, including omission, or obscuring, of significant information in disclosures. Transactions: • Significant transactions with related parties. • Significant amount of non-routine or non-systematic transactions including intercompany transactions and large revenue transactions at period end. • Transactions that are recorded based on management's intent, for example, debt refinancing, assets to be sold and classification of marketable securities.

Other events or conditions that may indicate risks of material misstatement at the financial statement level:

- Lack of personnel with appropriate accounting and financial reporting skills.
- Control deficiencies – particularly in the control environment, risk assessment process and process for monitoring, and especially those not addressed by management.
- Past misstatements, history of errors or a significant amount of adjustments at period end.

Appendix 3

(Ref: Para. 12(m), 21–26, A90–A181)

Understanding the Entity's System of Internal Control

1. The entity's system of internal control may be reflected in policy and procedures manuals, systems and forms, and the information embedded therein, and is effected by people. The entity's system of internal control is implemented by management, those charged with governance, and other personnel based on the structure of the entity. The entity's system of internal control can be applied, based on the decisions of management, those charged with governance or other personnel and in the context of legal or regulatory requirements, to the operating model of the entity, the legal entity structure, or a combination of these.

2. This appendix further explains the components of, as well as the limitations of, the entity's system of internal control as set out in paragraphs 12(m), 21–26, and A90–A181, as they relate to a financial statement audit.

3. Included within the entity's system of internal control are aspects that relate to the entity's reporting objectives, including its financial reporting objectives, but it may also include aspects that relate to its operations or compliance objectives, when such aspects are relevant to financial reporting.

> **Example**:
>
> Controls over compliance with laws and regulations may be relevant to financial reporting when such controls are relevant to the entity's preparation of disclosures of contingencies in the financial statements.

Components of the Entity's System of Internal Control

Control Environment

4. The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's system of internal control, and its importance in the entity. The control environment sets the tone of an organisation, influencing the control consciousness of its people, and provides the overall foundation for the operation of the other components of the entity's system of internal control.

5. An entity's control consciousness is influenced by those charged with governance, because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment in relation to participation by those charged with governance is therefore influenced by such matters as:

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

- The extent to which they evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework, including whether the financial statements include adequate disclosures.

6. The control environment encompasses the following elements:

   (a) *How management's responsibilities are carried out, such as creating and maintaining the entity's culture and demonstrating management's commitment to integrity and ethical values*. The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behaviour are the product of the entity's ethical and behavioural standards or codes of conduct, how they are communicated (e.g., through policy statements), and how they are reinforced in practice (e.g., through management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts). The communication of entity policies on integrity and ethical values may include the communication of behavioural standards to personnel through policy statements and codes of conduct and by example.

   (b) *When those charged with governance are separate from management, how those charged with governance demonstrate independence from management and exercise oversight of the entity's system of internal control*. An entity's control consciousness is influenced by those charged with governance. Considerations may include whether there are sufficient individuals who are independent from management and objective in their evaluations and decision-making; how those charged with governance identify and accept oversight responsibilities and whether those charged with governance retain oversight responsibility for management's design, implementation and conduct of the entity's system of internal control. The importance of the responsibilities of those charged with governance is recognised in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance. Other responsibilities of those charged with governance include oversight of the design and effective operation of whistle blower procedures.

   (c) *How the entity assigns authority and responsibility in pursuit of its objectives.* This may include considerations about:

      - Key areas of authority and responsibility and appropriate lines of reporting;
      - Policies relating to appropriate business practices, knowledge and experience of key personnel, and resources provided for carrying out duties; and
      - Policies and communications directed at ensuring that all personnel understand the entity's objectives, know how their individual actions interrelate and contribute to those objectives, and recognise how and for what they will be held accountable.

   (d) *How the entity attracts, develops, and retains competent individuals in alignment with its objectives.* This includes how the entity ensures the individuals have the knowledge and skills necessary to accomplish the tasks that define the individual's job, such as:

- Standards for recruiting the most qualified individuals – with an emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behaviour.
- Training policies that communicate prospective roles and responsibilities, including practices such as training schools and seminars that illustrate expected levels of performance and behaviour; and
- Periodic performance appraisals driving promotions that demonstrate the entity's commitment to the advancement of qualified personnel to higher levels of responsibility.

(e) *How the entity holds individuals accountable for their responsibilities in pursuit of the objectives of the entity's system of internal control.* This may be accomplished through, for example:

- Mechanisms to communicate and hold individuals accountable for performance of controls responsibilities and implement corrective actions as necessary;
- Establishing performance measures, incentives and rewards for those responsible for the entity's system of internal control, including how the measures are evaluated and maintain their relevance;
- How pressures associated with the achievement of control objectives impact the individual's responsibilities and performance measures; and
- How the individuals are disciplined as necessary.

The appropriateness of the above matters will be different for every entity depending on its size, the complexity of its structure and the nature of its activities.

The Entity's Risk Assessment Process

7. The entity's risk assessment process is an iterative process for identifying and analysing risks to achieving the entity's objectives, and forms the basis for how management or those charged with governance determine the risks to be managed.

8. For financial reporting purposes, the entity's risk assessment process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity's applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to manage them and the results thereof. For example, the entity's risk assessment process may address how the entity considers the possibility of unrecorded transactions or identifies and analyses significant estimates recorded in the financial statements.

9. Risks relevant to reliable financial reporting include external and internal events, transactions or circumstances that may occur and adversely affect an entity's ability to initiate, record, process, and report financial information consistent with the assertions of management in the financial statements. Management may initiate plans, programmes, or actions to address specific risks or it may decide to assume a risk because of cost or other considerations. Risks can arise or change due to circumstances such as the following:

- *Changes in operating environment*. Changes in the regulatory, economic or operating environment can result in changes in competitive pressures and significantly different risks.
- *New personnel*. New personnel may have a different focus on or understanding of the entity's system of internal control.
- *New or revamped information system*. Significant and rapid changes in the information system can change the risk relating to the entity's system of internal control.
- *Rapid growth*. Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.
- *New technology*. Incorporating new technologies into production processes or the information system may change the risk associated with the entity's system of internal control.
- *New business models, products, or activities*. Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with the entity's system of internal control.
- *Corporate restructurings*. Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with the entity's system internal control.
- *Expanded foreign operations*. The expansion or acquisition of foreign operations carries new and often unique risks that may affect internal control, for example, additional or changed risks from foreign currency transactions.
- *New accounting pronouncements*. Adoption of new accounting principles or changing accounting principles may affect risks in preparing financial statements.
- *Use of IT*. Risks relating to:
  - Maintaining the integrity of data and information processing;
  - Risks to the entity business strategy that arise if the entity's IT strategy does not effectively support the entity's business strategy; or
  - Changes or interruptions in the entity's IT environment or turnover of IT personnel or when the entity does not make necessary updates to the IT environment or such updates are not timely.

The Entity's Process to Monitor the System of Internal Control

10. The entity's process to monitor the system of internal control is a continual process to evaluate the effectiveness of the entity's system of internal control, and to take necessary remedial actions on a timely basis. The entity's process to monitor the entity's system of internal control may consist of ongoing activities, separate evaluations (conducted periodically), or some combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and may include regular management and supervisory activities. The entity's process will likely vary in scope and frequency depending on the assessment of the risks by the entity.

11. The objectives and scope of internal audit functions typically include activities designed to evaluate or monitor the effectiveness of the entity's system of internal control.[72] The entity's process to monitor the entity's system of internal control may include activities such as management's review of whether bank reconciliations are being prepared on a timely basis, internal auditors' evaluation of sales personnel's compliance with the entity's policies on terms of sales contracts, and a legal department's oversight of compliance with the entity's ethical or business practice policies. Monitoring is done also to ensure that controls continue to operate effectively over time. For example, if the timeliness and accuracy of bank reconciliations are not monitored, personnel are likely to stop preparing them.

12. Controls related to the entity's process to monitor the entity's system of internal control, including those that monitor underlying automated controls, may be automated or manual, or a combination of both. For example, an entity may use automated monitoring controls over access to certain technology with automated reports of unusual activity to management, who manually investigate identified anomalies.

13. When distinguishing between a monitoring activity and a control related to the information system, the underlying details of the activity are considered, especially when the activity involves some level of supervisory review. Supervisory reviews are not automatically classified as monitoring activities and it may be a matter of judgement whether a review is classified as a control related to the information system or a monitoring activity. For example, the intent of a monthly completeness control would be to detect and correct errors, where a monitoring activity would ask why errors are occurring and assign management the responsibility of fixing the process to prevent future errors. In simple terms, a control related to the information system responds to a specific risk, whereas a monitoring activity assesses whether controls within each of the five components of the entity's system of internal control are operating as intended.

14. Monitoring activities may include using information from communications from external parties that may indicate problems or highlight areas in need of improvement. Customers implicitly corroborate billing data by paying their invoices or complaining about their charges. In addition, regulators may communicate with the entity concerning matters that affect the functioning of the entity's system of internal control, for example, communications concerning examinations by bank regulatory agencies. Also, management may consider in performing monitoring activities any communications relating to the entity's system of internal control from external auditors.

The Information System and Communication

15. The information system relevant to the preparation of the financial statements consists of activities and policies, and accounting and supporting records, designed and established to:

    - Initiate, record and process entity transactions (as well as to capture, process and disclose information about events and conditions other than transactions) and to maintain accountability for the related assets, liabilities and equity;

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[72] ISA (NZ) 610 (Revised) and Appendix 4 of this ISA (NZ) provides further guidance related to internal audit.

- Resolve incorrect processing of transactions, for example, automated suspense files and procedures followed to clear suspense items out on a timely basis;
- Process and account for system overrides or bypasses to controls;
- Incorporate information from transaction processing in the general ledger (e.g., transferring of accumulated transactions from a subsidiary ledger);
- Capture and process information relevant to the preparation of the financial statements for events and conditions other than transactions, such as the depreciation and amortisation of assets and changes in the recoverability of assets; and
- Ensure information required to be disclosed by the applicable financial reporting framework is accumulated, recorded, processed, summarised and appropriately reported in the financial statements.

16. An entity's business processes include the activities designed to:
    - Develop, purchase, produce, sell and distribute an entity's products and services;
    - Ensure compliance with laws and regulations; and
    - Record information, including accounting and financial reporting information.

    Business processes result in the transactions that are recorded, processed and reported by the information system.

17. The quality of information affects management's ability to make appropriate decisions in managing and controlling the entity's activities and to prepare reliable financial reports.

18. Communication, which involves providing an understanding of individual roles and responsibilities pertaining to the entity's system of internal control, may take such forms as policy manuals, accounting and financial reporting manuals, and memoranda. Communication also can be made electronically, orally, and through the actions of management.

19. Communication by the entity of the financial reporting roles and responsibilities and of significant matters relating to financial reporting involves providing an understanding of individual roles and responsibilities pertaining to the entity's system of internal control relevant to financial reporting. It may include such matters as the extent to which personnel understand how their activities in the information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity.

Control Activities

20. Controls in the control activities component are identified in accordance with paragraph 26. Such controls include information processing controls and general IT controls, both of which may be manual or automated in nature. The greater the extent of automated controls, or controls involving automated aspects, that management uses and relies on in relation to its financial reporting, the more important it may become for the entity to implement general IT controls that address the continued functioning of the automated aspects of information processing controls. Controls in the control activities component may pertain to the following:

- *Authorisation and approvals*. An authorisation affirms that a transaction is valid (i.e., it represents an actual economic event or is within an entity's policy). An authorisation typically takes the form of an approval by a higher level of management or of verification and a determination if the transaction is valid. For example, a supervisor approves an expense report after reviewing whether the expenses seem reasonable and within policy. An example of an automated approval is when an invoice unit cost is automatically compared with the related purchase order unit cost within a pre-established tolerance level. Invoices within the tolerance level are automatically approved for payment. Those invoices outside the tolerance level are flagged for additional investigation.
- *Reconciliations* – Reconciliations compare two or more data elements. If differences are identified, action is taken to bring the data into agreement. Reconciliations generally address the completeness or accuracy of processing transactions.
- *Verifications* – Verifications compare two or more items with each other or compare an item with a policy, and will likely involve a follow-up action when the two items do not match or the item is not consistent with policy. Verifications generally address the completeness, accuracy, or validity of processing transactions.
- *Physical or logical controls, including those that address security of assets against unauthorised access, acquisition, use or disposal.* Controls that encompass:
    - The physical security of assets, including adequate safeguards such as secured facilities over access to assets and records.
    - The authorisation for access to computer programs and data files (i.e., logical access).
    - The periodic counting and comparison with amounts shown on control records (for example, comparing the results of cash, security and inventory counts with accounting records).

  The extent to which physical controls intended to prevent theft of assets are relevant to the reliability of financial statement preparation depends on circumstances such as when assets are highly susceptible to misappropriation.
- *Segregation of duties.* Assigning different people the responsibilities of authorising transactions, recording transactions, and maintaining custody of assets. Segregation of duties is intended to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of the person's duties.

  For example, a manager authorising credit sales is not responsible for maintaining accounts receivable records or handling cash receipts. If one person is able to perform all these activities the person could, for example, create a fictitious sale that could go undetected. Similarly, salespersons should not have the ability to modify product price files or commission rates.

  Sometimes segregation is not practical, cost effective, or feasible. For example, smaller and less complex entities may lack sufficient resources to achieve ideal segregation, and the cost of hiring additional staff may be prohibitive. In these situations, management may institute alternative controls. In the example above, if the salesperson can modify product price files, a detective control activity can be put in place to have personnel unrelated to the sales function periodically review whether and under what circumstances the salesperson changed prices.

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

Limitations of Internal Control

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

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

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

Appendix 4

(Ref: Para 14(a), 24(a)(ii), A25–A28, A118)

Considerations for Understanding an Entity's Internal Audit Function

This appendix provides further considerations relating to understanding the entity's internal audit function when such a function exists.

Objectives and Scope of the Internal Audit Function

1. The objectives and scope of an internal audit function, the nature of its responsibilities and its status within the organisation, including the function's authority and accountability, vary widely and depend on the size, complexity and structure of the entity and the requirements of management and, where applicable, those charged with governance. These matters may be set out in an internal audit charter or terms of reference.

2. The responsibilities of an internal audit function may include performing procedures and evaluating the results to provide assurance to management and those charged with governance regarding the design and effectiveness of risk management, the entity's system of internal control and governance processes. If so, the internal audit function may play an important role in the entity's process to monitor the entity's system of internal control. However, the responsibilities of the internal audit function may be focused on evaluating the economy, efficiency and effectiveness of operations and, if so, the work of the function may not directly relate to the entity's financial reporting.

Enquiries of the Internal Audit Function

3. If an entity has an internal audit function, enquiries 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, and may have findings based on its work, such as identified control deficiencies or risks, that may provide valuable input into the auditor's understanding of the entity and its environment, the applicable financial reporting framework, the entity's system of internal control, the auditor's risk assessments or other aspects of the audit. The auditor's enquiries are therefore made whether or not the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed.[73] Enquiries of particular relevance may be about matters the internal audit function has raised with those charged with governance and the outcomes of the function's own risk assessment process.

4. If, based on responses to the auditor's enquiries, it appears that there are findings that may be relevant to the entity's financial reporting and the audit of the financial statements, the auditor may consider it appropriate to read related reports of the internal audit function. Examples of reports of the internal audit function that may be relevant include the function's

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[73] The relevant requirements are contained in ISA (NZ) 610 (Revised 2013).

strategy and planning documents and reports that have been prepared for management or those charged with governance describing the findings of the internal audit function's examinations.

5. In addition, in accordance with ISA (NZ) 240,[74] if the internal audit function provides information to the auditor regarding any actual, suspected or alleged fraud, the auditor takes this into account in the auditor's identification of risk of material misstatement due to fraud.

6. Appropriate individuals within the internal audit function with whom enquiries are made are those who, in the auditor's judgement, have the appropriate knowledge, experience and authority, such as the chief internal audit executive or, depending on the circumstances, other personnel within the function. The auditor may also consider it appropriate to have periodic meetings with these individuals.

Consideration of the Internal Audit Function in Understanding the Control Environment

7. In understanding the control environment, the auditor may consider how management has responded to the findings and recommendations of the internal audit function regarding identified control deficiencies relevant to the preparation of the financial statements, including whether and how such responses have been implemented, and whether they have been subsequently evaluated by the internal audit function.

Understanding the Role that the Internal Audit Function Plays in the Entity's Process to Monitor the System of Internal Control

8. If the nature of the internal audit function's responsibilities and assurance activities are related to the entity's financial reporting, the auditor may also be able to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the auditor in obtaining audit evidence. Auditors may be more likely to be able to use the work of an entity's internal audit function when it appears, for example, based on experience in previous audits or the auditor's risk assessment procedures, that the entity has an internal audit function that is adequately and appropriately resourced relative to the complexity of the entity and the nature of its operations, and has a direct reporting relationship to those charged with governance.

9. If, based on the auditor's preliminary understanding of the internal audit function, the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed, ISA (NZ) 610 (Revised) applies.

10. As is further discussed in ISA (NZ) 610 (Revised), the activities of an internal audit function are distinct from other monitoring controls that may be relevant to financial reporting, such as reviews of management accounting information that are designed to contribute to how the entity prevents or detects misstatements.

11. Establishing communications with the appropriate individuals within an entity's internal audit function early in the engagement, and maintaining such communications throughout the engagement, can facilitate effective sharing of information. It creates an environment in which the auditor can be informed of significant matters that may come to the attention of

[74] ISA (NZ) 240, paragraph 19

the internal audit function when such matters may affect the work of the auditor. ISA (NZ) 200 discusses the importance of the auditor planning and performing the audit with professional scepticism,[75] including being alert to information that brings into question the reliability of documents and responses to enquiries to be used as audit evidence. Accordingly, communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring such information to the auditor's attention. The auditor is then able to take such information into account in the auditor's identification and assessment of risks of material misstatement.

[75] ISA (NZ) 200, paragraph 7

Appendix 5

(Ref: Para. 25(a), 26(b)–(c), A94, A166–A172)

Considerations for Understanding Information Technology (IT)

This appendix provides further matters that the auditor may consider in understanding the entity's use of IT in its system of internal control.

Understanding the Entity's Use of Information Technology in the Components of the Entity's System of Internal Control

1. An entity's system of internal control contains manual elements and automated elements (i.e., manual and automated controls and other resources used in the entity's system of internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. An entity's use of IT affects the manner in which the information relevant to the preparation of the financial statements in accordance with the applicable financial reporting framework is processed, stored and communicated, and therefore affects the manner in which the entity's system of internal control is designed and implemented. Each component of the entity's system of internal control may use some extent of IT.

   Generally, IT benefits an entity's system of internal control by enabling an entity to:

   - Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;
   - Enhance the timeliness, availability and accuracy of information;
   - Facilitate the additional analysis of information;
   - Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;
   - Reduce the risk that controls will be circumvented; and
   - Enhance the ability to achieve effective segregation of duties by implementing security controls in IT applications, databases and operating systems.

2. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement, and further audit procedures based thereon. Automated controls may be more reliable than manual controls because they cannot be as easily bypassed, ignored, or overridden, and they are also less prone to simple errors and mistakes. Automated controls may be more effective than manual controls in the following circumstances:

   - High volume of recurring transactions, or in situations where errors that can be anticipated or predicted can be prevented, or detected and corrected, through automation.
   - Controls where the specific ways to perform the control can be adequately designed and automated.

Understanding the Entity's Use of Information Technology in the Information System (Ref: Para. 25(a))

3. The entity's information system may include the use of manual and automated elements, which also affect the manner in which transactions are initiated, recorded, processed, and reported. In particular, procedures to initiate, record, process and report transactions may be enforced through the IT applications used by the entity, and how the entity has configured those applications. In addition, records in the form of digital information may replace or supplement records in the form of paper documents.

4. In obtaining an understanding of the IT environment relevant to the flows of transactions and information processing in the information system, the auditor gathers information about the nature and characteristics of the IT applications used, as well as the supporting IT infrastructure and IT. The following table includes examples of matters that the auditor may consider in obtaining the understanding of the IT environment and includes examples of typical characteristics of IT environments based on the complexity of IT applications used in the entity's information system. However, such characteristics are directional and may differ depending on the nature of the specific IT applications in use by an entity.

	Examples of typical characteristics of:		
	Non-complex commercial software	Mid-size and moderately complex commercial software or IT applications	Large or complex IT applications (e.g., ERP systems)
Matters related to extent of automation and use of data:			
• The extent of automated procedures for processing, and the complexity of those procedures, including, whether there is highly automated, paperless processing.	N/A	N/A	Extensive and often complex automated procedures
• The extent of the entity's reliance on system-generated reports in the processing of information.	Simple automated report logic	Simple relevant automated report logic	Complex automated report logic; Report-writer software
• How data is input (i.e., manual input, customer	Manual data inputs	Small number of data inputs or simple interfaces	Large number of data inputs or

	Examples of typical characteristics of:		
	Non-complex commercial software	Mid-size and moderately complex commercial software or IT applications	Large or complex IT applications (e.g., ERP systems)
or vendor input, or file load).			complex interfaces
• How IT facilitates communication between applications, databases or other aspects of the IT environment, internally and externally, as appropriate, through system interfaces.	No automated interfaces (manual inputs only)	Small number of data inputs or simple interfaces	Large number of data inputs or complex interfaces
• The volume and complexity of data in digital form being processed by the information system, including whether accounting records or other information are stored in digital form and the location of stored data.	Low volume of data or simple data that is able to be verified manually; Data available locally	Low volume of data or simple data	Large volume of data or complex data; Data warehouses;[76] Use of internal or external IT service providers (e.g., third-party storage or hosting of data)
Matters related to the IT applications and IT infrastructure:			
• The type of application (e.g., a commercial application with little or no customisation, or a highly-customised or	Purchased application with little or no customisation	Purchased application or simple legacy or low-end ERP applications with	Custom developed applications or more complex ERPs with

[76] A data warehouse is generally described as a central repository of integrated data from one or more disparate sources (such as multiple databases) from which reports may be generated or that may be used by the entity for other data analysis activities. A report-writer is an IT application that is used to extract data from one or more sources (such as a data warehouse, a database or an IT application) and present the data in a specified format.

	Examples of typical characteristics of:		
	Non-complex commercial software	Mid-size and moderately complex commercial software or IT applications	Large or complex IT applications (e.g., ERP systems)
highly-integrated application that may have been purchased and customised, or developed in-house).		little or no customisation	significant customisation
• The complexity of the nature of the IT applications and the underlying IT infrastructure.	Small, simple laptop or client server-based solution	Mature and stable mainframe, small or simple client server, software as a service cloud	Complex mainframe, large or complex client server, web-facing, infrastructure as a service cloud
• Whether there is third-party hosting or outsourcing of IT.	If outsourced, competent, mature, proven provider (e.g., cloud provider)	If outsourced, competent, mature, proven provider (e.g., cloud provider)	Competent, mature proven provider for certain applications and new or start-up provider for others
• Whether the entity is using emerging technologies that affect its financial reporting.	No use of emerging technologies	Limited use of emerging technologies in some applications	Mixed use of emerging technologies across platforms
Matters related to IT processes:			
• The personnel involved in maintaining the IT environment (the number and skill level of the IT support resources that manage security and changes to the IT environment).	Few personnel with limited IT knowledge to process vendor upgrades and manage access	Limited personnel with IT skills / dedicated to IT	Dedicated IT departments with skilled personnel, including programming skills

	Examples of typical characteristics of:		
	Non-complex commercial software	Mid-size and moderately complex commercial software or IT applications	Large or complex IT applications (e.g., ERP systems)
• The complexity of processes to manage access rights.	Single individual with administrative access manage access rights	Few individuals with administrative access manage access rights	Complex processes managed by IT department for access rights
• The complexity of the security over the IT environment, including vulnerability of the IT applications, databases, and other aspects of the IT environment to cyber risks, particularly when there are web-based transactions or transactions involving external interfaces.	Simple on-premise access with no external web-facing elements	Some web-based applications with primarily simple, role-based security	Multiple platforms with web-based access and complex security models
• Whether program changes have been made to the manner in which information is processed, and the extent of such changes during the period.	Commercial software with no source code installed	Some commercial applications with no source code and other mature applications with a small number or simple changes; traditional systems development lifecycle	New or large number or complex changes, several development cycles each year
• The extent of change within the IT environment (e.g., new aspects of the IT environment or significant changes in the IT applications or the underlying IT infrastructure).	Changes limited to version upgrades of commercial software	Changes consist of commercial software upgrades, ERP version upgrades, or legacy enhancements	New or large number or complex changes, several development cycles each year, heavy ERP customisation

	Examples of typical characteristics of:		
	Non-complex commercial software	Mid-size and moderately complex commercial software or IT applications	Large or complex IT applications (e.g., ERP systems)
• Whether there was a major data conversion during the period and, if so, the nature and significance of the changes made, and how the conversion was undertaken.	Software upgrades provided by vendor; No data conversion features for upgrade	Minor version upgrades for commercial software applications with limited data being converted	Major version upgrade, new release, platform change

Emerging Technologies

5. Entities may use emerging technologies (e.g., blockchain, robotics or artificial intelligence) because such technologies may present specific opportunities to increase operational efficiencies or enhance financial reporting. When emerging technologies are used in the entity's information system relevant to the preparation of the financial statements, the auditor may include such technologies in the identification of IT applications and other aspects of the IT environment that are subject to risks arising from the use of IT. While emerging technologies may be seen to be more sophisticated or more complex compared to existing technologies, the auditor's responsibilities in relation to IT applications and identified general IT controls in accordance with paragraph 26(b)–(c) remain unchanged.

Scalability

6. Obtaining an understanding of the entity's IT environment may be more easily accomplished for a less complex entity that uses commercial software and when the entity does not have access to the source code to make any program changes. Such entities may not have dedicated IT resources but may have a person assigned in an administrator role for the purpose of granting employee access or installing vendor-provided updates to the IT applications. Specific matters that the auditor may consider in understanding the nature of a commercial accounting software package, which may be the single IT application used by a less complex entity in its information system, may include:

   - The extent to which the software is well established and has a reputation for reliability;
   - The extent to which it is possible for the entity to modify the source code of the software to include additional modules (i.e., add-ons) to the base software, or to make direct changes to data;
   - The nature and extent of modifications that have been made to the software. Although an entity may not be able to modify the source code of the software, many software

packages allow for configuration (e.g., setting or amending reporting parameters). These do not usually involve modifications to source code; however, the auditor may consider the extent to which the entity is able to configure the software when considering the completeness and accuracy of information produced by the software that is used as audit evidence; and

- The extent to which data related to the preparation of the financial statements can be directly accessed (i.e., direct access to the database without using the IT application) and the volume of data that is processed. The greater the volume of data, the more likely the entity may need controls that address maintaining the integrity of the data, which may include general IT controls over unauthorised access and changes to the data.

7. Complex IT environments may include highly-customised or highly-integrated IT applications and may therefore require more effort to understand. Financial reporting processes or IT applications may be integrated with other IT applications. Such integration may involve IT applications that are used in the entity's business operations and that provide information to the IT applications relevant to the flows of transactions and information processing in the entity's information system. In such circumstances, certain IT applications used in the entity's business operations may also be relevant to the preparation of the financial statements. Complex IT environments also may require dedicated IT departments that have structured IT processes supported by personnel that have software development and IT environment maintenance skills. In other cases, an entity may use internal or external service providers to manage certain aspects of, or IT processes within, its IT environment (e.g., third-party hosting).

Identifying IT Applications that are Subject to Risks Arising from the use of IT

8. Through understanding the nature and complexity of the entity's IT environment, including the nature and extent of information processing controls, the auditor may determine which IT applications the entity is relying upon to accurately process and maintain the integrity of financial information. The identification of IT applications on which the entity relies may affect the auditor's decision to test the automated controls within such IT applications, assuming that such automated controls address identified risks of material misstatement. Conversely, if the entity is not relying on an IT application, the automated controls within such IT application are unlikely to be appropriate or sufficiently precise for purposes of operating effectiveness tests. Automated controls that may be identified in accordance with paragraph 26(b) may include, for example, automated calculations or input, processing and output controls, such as a three-way match of a purchase order, vendor shipping document, and vendor invoice. When automated controls are identified by the auditor and the auditor determines through the understanding of the IT environment that the entity is relying on the IT application that includes those automated controls, it may be more likely for the auditor to identify the IT application as one that is subject to risks arising from the use of IT.

9. In considering whether the IT applications for which the auditor has identified automated controls are subject to risks arising from the use of IT, the auditor is likely to consider whether, and the extent to which, the entity may have access to source code that enables management to make program changes to such controls or the IT applications. The extent to

which the entity makes program or configuration changes and the extent to which the IT processes over such changes are formalised may also be relevant considerations. The auditor is also likely to consider the risk of inappropriate access or changes to data.

10. System-generated reports that the auditor may intend to use as audit evidence may include, for example, a trade receivable aging report or an inventory valuation report. For such reports, the auditor may obtain audit evidence about the completeness and accuracy of the reports by substantively testing the inputs and outputs of the report. In other cases, the auditor may plan to test the operating effectiveness of the controls over the preparation and maintenance of the report, in which case the IT application from which it is produced is likely to be subject to risks arising from the use of IT. In addition to testing the completeness and accuracy of the report, the auditor may plan to test the operating effectiveness of general IT controls that address risks related to inappropriate or unauthorised program changes to, or data changes in, the report.

11. Some IT applications may include report-writing functionality within them while some entities may also utilise separate report-writing applications (i.e., report-writers). In such cases, the auditor may need to determine the sources of system-generated reports (i.e., the application that prepares the report and the data sources used by the report) to determine the IT applications subject to risks arising from the use of IT.

12. The data sources used by IT applications may be databases that, for example, can only be accessed through the IT application or by IT personnel with database administration privileges. In other cases, the data source may be a data warehouse that may itself be considered to be an IT application subject to risks arising from the use of IT.

13. The auditor may have identified a risk for which substantive procedures alone are not sufficient because of the entity's use of highly-automated and paperless processing of transactions, which may involve multiple integrated IT applications. In such circumstances, the controls identified by the auditor are likely to include automated controls. Further, the entity may be relying on general IT controls to maintain the integrity of the transactions processed and other information used in processing. In such cases, the IT applications involved in the processing and the storage of the information are likely subject to risks arising from the use of IT.

End-User Computing

14. Although audit evidence may also come in the form of system-generated output that is used in a calculation performed in an end-user computing tool (e.g., spreadsheet software or simple databases), such tools are not typically identified as IT applications in the context of paragraph 26(b). Designing and implementing controls around access and change to end-user computing tools may be challenging, and such controls are rarely equivalent to, or as effective as, general IT controls. Rather, the auditor may consider a combination of information processing controls, taking into account the purpose and complexity of the end-user computing involved, such as:

    - Information processing controls over the initiation and processing of the source data, including relevant automated or interface controls to the point from which the data is extracted (i.e., the data warehouse);

- Controls to check that the logic is functioning as intended, for example, controls which 'prove' the extraction of data, such as reconciling the report to the data from which it was derived, comparing the individual data from the report to the source and vice versa, and controls which check the formulas or macros; or
- Use of validation software tools, which systematically check formulas or macros, such as spreadsheet integrity tools.

Scalability

15. The entity's ability to maintain the integrity of information stored and processed in the information system may vary based on the complexity and volume of the related transactions and other information. The greater the complexity and volume of data that supports a significant class of transactions, account balance or disclosure, the less likely it may become for the entity to maintain integrity of that information through information processing controls alone (e.g., input and output controls or review controls). It also becomes less likely that the auditor will be able to obtain audit evidence about the completeness and accuracy of such information through substantive testing alone when such information is used as audit evidence. In some circumstances, when volume and complexity of transactions are lower, management may have an information processing control that is sufficient to verify the accuracy and completeness of the data (e.g., individual sales orders processed and billed may be reconciled to the hard copy originally entered into the IT application). When the entity relies on general IT controls to maintain the integrity of certain information used by IT applications, the auditor may determine that the IT applications that maintain that information are subject to risks arising from the use of IT.

Example characteristics of an IT application that is likely not subject to risks arising from IT	Example characteristics of an IT application that is likely subject to risks arising from IT
• Standalone applications. • The volume of data (transactions) is not significant. • The application's functionality is not complex. • Each transaction is supported by original hard copy documentation.	• Applications are interfaced. • The volume of data (transactions) is significant. • The application's functionality is complex as: – The application automatically initiates transactions; and – There are a variety of complex calculations underlying automated entries.
IT application is likely not subject to risks arising from IT because: • The volume of data is not significant and therefore management is not relying upon general IT controls to process or maintain the data.	IT application is likely subject to risks arising from IT because: • Management relies on an application system to process or maintain data as the volume of data is significant.

• Management does not rely on automated controls or other automated functionality. The auditor has not identified automated controls in accordance with paragraph 26(a). • Although management uses system-generated reports in their controls, it does not rely on these reports. Instead, it reconciles the reports back to the hard copy documentation and verifies the calculations in the reports. • The auditor will directly test information produced by the entity used as audit evidence.	• Management relies upon the application system to perform certain automated controls that the auditor has also identified.

Other Aspects of the IT Environment that Are Subject to Risks Arising from the Use of IT

16. When the auditor identifies IT applications that are subject to risks arising from the use of IT, other aspects of the IT environment are also typically subject to risks arising from the use of IT. The IT infrastructure includes the databases, operating system, and network. Databases store the data used by IT applications and may consist of many interrelated data tables. Data in databases may also be accessed directly through database management systems by IT or other personnel with database administration privileges. The operating system is responsible for managing communications between hardware, IT applications, and other software used in the network. As such, IT applications and databases may be directly accessed through the operating system. A network is used in the IT infrastructure to transmit data and to share information, resources and services through a common communications link. The network also typically establishes a layer of logical security (enabled through the operating system) for access to the underlying resources.

17. When IT applications are identified by the auditor to be subject to risks arising from IT, the database(s) that stores the data processed by an identified IT application is typically also identified. Similarly, because an IT application's ability to operate is often dependent on the operating system and IT applications and databases may be directly accessed from the operating system, the operating system is typically subject to risks arising from the use of IT. The network may be identified when it is a central point of access to the identified IT applications and related databases or when an IT application interacts with vendors or external parties through the internet, or when web-facing IT applications are identified by the auditor.

Identifying Risks Arising from the Use of IT and General IT Controls

18. Examples of risks arising from the use of IT include risks related to inappropriate reliance on IT applications that are inaccurately processing data, processing inaccurate data, or both, such as

- Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- Unauthorised changes to data in master files.
- Unauthorised changes to IT applications or other aspects of the IT environment.
- Failure to make necessary changes to IT applications or other aspects of the IT environment.
- Inappropriate manual intervention.
- Potential loss of data or inability to access data as required.

19. The auditor's consideration of unauthorised access may include risks related to unauthorised access by internal or external parties (often referred to as cybersecurity risks). Such risks may not necessarily affect financial reporting, as an entity's IT environment may also include IT applications and related data that address operational or compliance needs. It is important to note that cyber incidents usually first occur through the perimeter and internal network layers, which tend to be further removed from the IT application, database and operating systems that affect the preparation of the financial statements. Accordingly, if information about a security breach has been identified, the auditor ordinarily considers the extent to which such a breach had the potential to affect financial reporting. If financial reporting may be affected, the auditor may decide to understand, and test the related controls to determine the possible impact or scope of potential misstatements in the financial statements or may determine that the entity has provided adequate disclosures in relation to such security breach.

20. In addition, laws and regulations that may have a direct or indirect effect on the entity's financial statements may include data protection legislation. Considering an entity's compliance with such laws or regulations, in accordance with ISA (NZ) 250 (Revised),[77] may involve understanding the entity's IT processes and general IT controls that the entity has implemented to address the relevant laws or regulations.

21. General IT controls are implemented to address risks arising from the use of IT. Accordingly, the auditor uses the understanding obtained about the identified IT applications and other aspects of the IT environment and the applicable risks arising from the use of IT in determining the general IT controls to identify. In some cases, an entity may use common IT

[77] ISA (NZ) 250 (Revised)

processes across its IT environment or across certain IT applications, in which case common risks arising from the use of IT and common general IT controls may be identified.

22. In general, a greater number of general IT controls related to IT applications and databases are likely to be identified than for other aspects of the IT environment. This is because these aspects are the most closely concerned with the information processing and storage of information in the entity's information system. In identifying general IT controls, the auditor may consider controls over actions of both end users and of the entity's IT personnel or IT service providers.

23. Appendix 6 provides further explanation of the nature of the general IT controls typically implemented for different aspects of the IT environment. In addition, examples of general IT controls for different IT processes are provided.

Appendix 6

(Ref: Para. 25(c)(ii), A173–A174)

Considerations for Understanding General IT Controls

This appendix provides further matters that the auditor may consider in understanding general IT controls.

1. The nature of the general IT controls typically implemented for each of the aspects of the IT environment:

   (a) Applications

   General IT controls at the IT application layer will correlate to the nature and extent of application functionality and the access paths allowed in the technology. For example, more controls will be relevant for highly-integrated IT applications with complex security options than a legacy IT application supporting a small number of account balances with access methods only through transactions.

   (b) Database

   General IT controls at the database layer typically address risks arising from the use of IT related to unauthorised updates to financial reporting information in the database through direct database access or execution of a script or program.

   (c) Operating system

   General IT controls at the operating system layer typically address risks arising from the use of IT related to administrative access, which can facilitate the override of other controls. This includes actions such as compromising other user's credentials, adding new, unauthorised users, loading malware or executing scripts or other unauthorised programs.

   (d) Network

   General IT controls at the network layer typically address risks arising from the use of IT related to network segmentation, remote access, and authentication. Network controls may be relevant when an entity has web-facing applications used in financial reporting. Network controls are also may be relevant when the entity has significant business partner relationships or third-party outsourcing, which may increase data transmissions and the need for remote access.

2. Examples of general IT controls that may exist, organised by IT process include:

   (a) Process to manage access:

   - *Authentication*

     Controls that ensure a user accessing the IT application or other aspect of the IT environment is using the user's own log-in credentials (i.e., the user is not using another user's credentials).

- *Authorisation*

  Controls that allow users to access the information necessary for their job responsibilities and nothing further, which facilitates appropriate segregation of duties.

- *Provisioning*

  Controls to authorise new users and modifications to existing users' access privileges.

- *Deprovisioning*

  Controls to remove user access upon termination or transfer.

- *Privileged access*

  Controls over administrative or powerful users' access.

- *User access reviews*

  Controls to recertify or evaluate user access for ongoing authorisation over time.

- *Security configuration controls*

  Each technology generally has key configuration settings that help restrict access to the environment.

- *Physical access*

  Controls over physical access to the data center and hardware, as such access may be used to override other controls.

(b) Process to manage program or other changes to the IT environment:

- *Change management process*

  Controls over the process to design, program, test and migrate changes to a production (i.e., end user) environment.

- *Segregation of duties over change migration*

  Controls that segregate access to make and migrate changes to a production environment.

- *Systems development or acquisition or implementation*

  Controls over initial IT application development or implementation (or in relation to other aspects of the IT environment).

- *Data conversion*

  Controls over the conversion of data during development, implementation or upgrades to the IT environment.

(c) Process to manage IT operations

- *Job scheduling*

Controls over access to schedule and initiate jobs or programs that may affect financial reporting.

- *Job monitoring*

  Controls to monitor financial reporting jobs or programs for successful execution.

- *Backup and recovery*

  Controls to ensure backups of financial reporting data occur as planned and that such data is available and able to be accessed for timely recovery in the event of an outage or attack.

- *Intrusion detection*

  Controls to monitor for vulnerabilities and or intrusions in the IT environment.

The table below illustrates examples of general IT controls to address examples of risks arising from the use of IT, including for different IT applications based on their nature.

Process	**Risks**	**Controls**	**IT Applications**		
IT Process	**Example Risks Arising from the Use of IT**	**Example General IT Controls**	**Non-complex commercial software – Applicable (yes / no)**	**Mid-size and moderately complex commercial software or IT applications – Applicable (yes / no)**	**Large or complex IT applications (e.g., ERP systems) – Applicable (yes / no)**
Manage Access	User-access privileges: Users have access privileges beyond those necessary to perform their assigned duties, which may create improper segregation of duties.	Management approves the nature and extent of user-access privileges for new and modified user access, including standard application profiles/roles, critical financial reporting transactions, and segregation of duties	Yes – instead of user access reviews noted below	Yes	Yes

Process	**Risks**	**Controls**	**IT Applications**		
IT Process	**Example Risks Arising from the Use of IT**	**Example General IT Controls**	**Non-complex commercial software – Applicable (yes / no)**	**Mid-size and moderately complex commercial software or IT applications – Applicable (yes / no)**	**Large or complex IT applications (e.g., ERP systems) – Applicable (yes / no)**
		Access for terminated or transferred users is removed or modified in a timely manner	Yes – instead of user access reviews below	Yes	Yes
		User access is periodically reviewed	Yes – instead of provisioning/ Deprovisioning controls above	Yes – for certain applications	Yes
		Segregation of duties is monitored and conflicting access is either removed or mapped to mitigating controls, which are documented and tested	N/A – no system enabled segregation	Yes – for certain applications	Yes
		Privileged-level access (e.g., configuration, data and security administrators) is authorised and appropriately restricted	Yes – likely at IT application layer only	Yes – at IT application and certain layers of IT environment for platform	Yes – at all layers of IT environment for platform

Process	**Risks**	**Controls**	**IT Applications**		
IT Process	**Example Risks Arising from the Use of IT**	**Example General IT Controls**	**Non-complex commercial software – Applicable (yes / no)**	**Mid-size and moderately complex commercial software or IT applications – Applicable (yes / no)**	**Large or complex IT applications (e.g., ERP systems) – Applicable (yes / no)**
Manage Access	Direct data access: Inappropriate changes are made directly to financial data through means other than application transactions.	Access to application data files or database objects/tables/data is limited to authorised personnel, based on their job responsibilities and assigned role, and such access is approved by management	N/A	Yes – for certain applications and databases	Yes
Manage Access	System settings: Systems are not adequately configured or updated to restrict system access to properly authorised and appropriate users.	Access is authenticated through unique user IDs and passwords or other methods as a mechanism for validating that users are authorised to gain access to the system. Password parameters meet company or industry standards (e.g., password minimum length and complexity,	Yes – password authentication only	Yes – mix of password and multi-factor authentication	Yes

Process	**Risks**	**Controls**	**IT Applications**		
IT Process	**Example Risks Arising from the Use of IT**	**Example General IT Controls**	**Non-complex commercial software – Applicable (yes / no)**	**Mid-size and moderately complex commercial software or IT applications – Applicable (yes / no)**	**Large or complex IT applications (e.g., ERP systems) – Applicable (yes / no)**
		expiration, account lockout)			
		The key attributes of the security configuration are appropriately implemented	N/A – no technical security configurations exist	Yes – for certain applications and databases	Yes
Manage Change	Application changes: Inappropriate changes are made to application systems or programs that contain relevant automated controls (i.e., configurable settings, automated algorithms, automated calculations, and automated data extraction) or report logic.	Application changes are appropriately tested and approved before being moved into the production environment	N/A – would verify no source code installed	Yes – for non-commercial software	Yes
		Access to implement changes into the application production environment is appropriately restricted and segregated from the development environment	N/A	Yes – for non-commercial software	Yes

Process	Risks	Controls	IT Applications		
IT Process	**Example Risks Arising from the Use of IT**	**Example General IT Controls**	**Non-complex commercial software – Applicable (yes / no)**	**Mid-size and moderately complex commercial software or IT applications – Applicable (yes / no)**	**Large or complex IT applications (e.g., ERP systems) – Applicable (yes / no)**
Manage Change	Database changes: Inappropriate changes are made to the database structure and relationships between the data.	Database changes are appropriately tested and approved before being moved into the production environment	N/A – no database changes made at entity	Yes – for non-commercial software	Yes
Manage Change	System software changes: Inappropriate changes are made to system software (e.g., operating system, network, change-management software, access-control software).	System software changes are appropriately tested and approved before being moved to production	N/A – no system software changes are made at entity	Yes	Yes

Process	Risks	Controls	IT Applications		
IT Process	**Example Risks Arising from the Use of IT**	**Example General IT Controls**	**Non-complex commercial software – Applicable (yes / no)**	**Mid-size and moderately complex commercial software or IT applications – Applicable (yes / no)**	**Large or complex IT applications (e.g., ERP systems) – Applicable (yes / no)**
Manage Change	Data conversion: Data converted from legacy systems or previous versions introduces data errors if the conversion transfers incomplete, redundant, obsolete, or inaccurate data.	Management approves the results of the conversion of data (e.g., balancing and reconciliation activities) from the old application system or data structure to the new application system or data structure and monitors that the conversion is performed in accordance with established conversion policies and procedures	N/A – Addressed through manual controls	Yes	Yes
IT Operations	Network: The network does not adequately prevent unauthorised users from gaining inappropriate access to	Access is authenticated through unique user IDs and passwords or other methods as a mechanism for validating that users are authorised to gain	N/A – no separate network authentication method exists	Yes	Yes

Process	Risks	Controls	IT Applications		
IT Process	**Example Risks Arising from the Use of IT**	**Example General IT Controls**	**Non-complex commercial software – Applicable (yes / no)**	**Mid-size and moderately complex commercial software or IT applications – Applicable (yes / no)**	**Large or complex IT applications (e.g., ERP systems) – Applicable (yes / no)**
	information systems.	access to the system. Password parameters meet company or professional policies and standards (e.g., password minimum length and complexity, expiration, account lockout)			
		Network is architected to segment web-facing applications from the internal network, where ICFR relevant applications are accessed	N/A – no network segmentation employed	Yes – with judgement	Yes – with judgement
		On a periodic basis, vulnerability scans of the network perimeter are performed by the network management team, which also	N/A	Yes – with judgement	Yes – with judgement

Process	**Risks**	**Controls**	**IT Applications**		
IT Process	**Example Risks Arising from the Use of IT**	**Example General IT Controls**	**Non-complex commercial software – Applicable (yes / no)**	**Mid-size and moderately complex commercial software or IT applications – Applicable (yes / no)**	**Large or complex IT applications (e.g., ERP systems) – Applicable (yes / no)**
		investigates potential vulnerabilities			
		On a periodic basis, alerts are generated to provide notification of threats identified by the intrusion detection systems. These threats are investigated by the network management team	N/A	Yes – with judgement	Yes – with judgement
		Controls are implemented to restrict Virtual Private Network (VPN) access to authorised and appropriate users	N/A – no VPN	Yes – with judgement	Yes – with judgement
IT Operations	Data backup and recovery: Financial data cannot be recovered or accessed in a timely manner	Financial data is backed up on a regular basis according to an established schedule and frequency	N/A – relying on manual backups by finance team	Yes	Yes

Process	Risks	Controls	IT Applications		
IT Process	**Example Risks Arising from the Use of IT**	**Example General IT Controls**	**Non-complex commercial software – Applicable (yes / no)**	**Mid-size and moderately complex commercial software or IT applications – Applicable (yes / no)**	**Large or complex IT applications (e.g., ERP systems) – Applicable (yes / no)**
	when there is a loss of data.				
IT Operations	Job scheduling: Production systems, programs, or jobs result in inaccurate, incomplete, or unauthorised processing of data.	Only authorised users have access to update the batch jobs (including interface jobs) in the job scheduling software	N/A – no batch jobs	Yes – for certain applications	Yes
		Critical systems, programs, or jobs are monitored, and processing errors are corrected to ensure successful completion	N/A – no job monitoring	Yes – for certain applications	Yes

ACCOMPANYING ATTACHMENT: CONFORMITY TO THE INTERNATIONAL STANDARDS ON AUDITING

This conformity statement accompanies but is not part of ISA (NZ) 315 (Revised 2019).

Conformity with International Standards on Auditing

This International Standard on Auditing (New Zealand) (ISA (NZ)) conforms to International Standard on Auditing (ISA) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement,* issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

Paragraphs that have been added to this ISA (NZ) (and do not appear in the text of the equivalent ISA) are identified with the prefix "NZ".

This ISA (NZ) incorporates terminology and definitions used in New Zealand.

Compliance with this ISA (NZ) enables compliance with ISA 315 (Revised 2019).

Comparison with Australian Auditing Standards

This section will be completed after the AUASB issues its revised standard.

CONFORMING AND CONSEQUENTIAL AMENDMENTS TO OTHER INTERNATIONAL STANDARDS (NEW ZEALAND)

Note: The following are conforming amendments to other International Standards (New Zealand) as a result of the approval of ISA (NZ) 315 (Revised 2019). These amendments will become effective at the same time as ISA (NZ) 315 (Revised 2019), ~~-~~and are shown with marked changes from the latest approved versions of the International Standards (New Zealand) that are amended. The footnote numbers within these amendments do not align with the International Standards (New Zealand) that are amended, and reference should be made to those International Standards (New Zealand).

ISA (NZ) 200, *Overall objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*

Scope of this ISA (NZ)

…

An Audit of Financial Statements

...

7. The ISAs (NZ) contain objectives, requirements and application and other explanatory material that are designed to support the auditor in obtaining reasonable assurance. The ISAs (NZ) 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 statements based on conclusions drawn from the audit evidence obtained.

…

Effective Date

…

Overall Objectives of the Auditor

…

Definitions

13. For purposes of the ISAs (NZ), the following terms have the meanings attributed below:

    …

(n) Risk of material misstatement – The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level: (Ref: Para. A15a)

  (i) Inherent risk – The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

  (ii) Control risk – The risk that a misstatement that could occur in an assertion about a class of transactions, 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.

…

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

…

Professional Scepticism

…

Professional Judgement

…

Sufficient Appropriate Audit Evidence and Audit Risk

17. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: Para. A30–A54)

Conduct of an Audit in Accordance with ISAs (NZ)

Complying with ISAs (NZ) Relevant to the Audit

…

19. The auditor shall have an understanding of the entire text of an ISA (NZ), including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A60–A68)

…

Objectives Stated in Individual ISAs (NZ)

…

Complying with Relevant Requirements

…

Failure to Achieve an Objective

…

Application and Other Explanatory Material

An Audit of Financial Statements

Scope of the Audit (Ref: Para. 3)

…

Preparation of the Financial Statements (Ref: Para. 4)

…

Considerations Specific to Audits in the Public Sector

…

Form of the Auditor's Opinion (Ref: Para. 8)

…

Definitions

Financial Statements (Ref: Para. 13(f))

…

Risk of Material Misstatement (Ref: Para. 13(n))

A15a. For the purposes of the ISAs (NZ), a risk of material misstatement exists when there is a reasonable possibility of:

(a) A misstatement occurring (i.e., its likelihood); and

(b) Being material if it were to occur (i.e., its magnitude).

Ethical Requirements Relating to an Audit of Financial Statements (Ref: Para. 14)

…

Professional Scepticism (Ref: Para. 15)

…

Professional Judgement (Ref: Para. 16)

…

Sufficient Appropriate Audit Evidence and Audit Risk (Ref: Para. 5 and 17)

Sufficiency and Appropriateness of Audit Evidence

NZA30.1 Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit[1]) or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's

1 ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~*, paragraph 16~~9~~

accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, the refusal of those charged with governance to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

…

Audit Risk

…

Risks of Material Misstatement

…

A40. Inherent risk is influenced by inherent risk factors. ~~higher for some assertions and related classes of transactions, account balances, and disclosures than for others.~~ Depending on the degree to which the inherent risk factors affect the susceptibility to misstatement of an assertion, the level of inherent risk varies on a scale that is referred to as 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~~ account~~s~~ 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.

A40a. 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.

A41. 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 statements. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, 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 ISAs (NZ) 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.[2]

A42.[3] The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made. The ISAs (NZ) typically ~~do not ordinarily~~ refer to ~~inherent risk and control risk separately, but rather to a combined assessment of~~ the “risks of material misstatement~~.~~” rather than to inherent risk and control risk separately. However, ISA (NZ) ~~540~~315 (Revised 2019)[4] requires a~~ separate assessment of~~ inherent risk to be assessed separately from ~~and~~ control risk to provide a basis for designing and performing further audit procedures to respond to the assessed risks of material misstatement at the assertion level~~, including significant risks, for accounting estimates at the assertion level~~ in accordance with ISA (NZ) 330.[5] ~~In identifying and assessing risks of material misstatement for significant classes of transactions, account balances or disclosures other than accounting estimates, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations.~~

A43. ISA (NZ) 315 (Revised 2019) establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.

A43a. 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.[6]

Detection Risk

…

Inherent Limitations of an Audit

…

The Nature of Financial Reporting

…

The Nature of Audit Procedures

…

Timeliness of Financial Reporting and the Balance between Benefit and Cost

…

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2 ISA (NZ) 330, *The Auditor’s Reponses to Assessed Risks*, paragraphs 7–17

3 Note that paragraph A42 of ISA (NZ) 200 is marked to the updated paragraph presented separately as a conforming amendment relating to ISA (NZ) 540 (Revised) and its conforming amendments.

4 ISA (NZ) ~~540~~315 (Revised 2019), ~~*Auditing Accounting Estimates and Disclosures,* paragraph 15~~*Identifying and Assessing the Risks of Material Misstatement*

~~5 ISA (NZ) 330, paragraph 7(b)~~

6 ISA (NZ) 330, paragraph 6

A52. In light of the approaches described in paragraph A51, the ISAs (NZ) contain requirements for the planning and performance of the audit and require the auditor, among other things, to:

- Have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities;[7] and
- Use testing and other means of examining populations in a manner that provides a reasonable basis for the auditor to draw conclusions about the population.[8]

Other Matters that Affect the Inherent Limitations of an Audit

…

Conduct of an Audit in Accordance with ISAs (NZ)

Nature of the ISAs (NZ) (Ref: Para. 18)

…

Considerations Specific to Audits in the Public Sector

…

Contents of the ISAs (NZ) (Ref: Para. 19)

A60. In addition to objectives and requirements (requirements are expressed in the ISAs (NZ) using "shall"), an ISA (NZ) contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the ISA (NZ), and definitions. The entire text of an ISA (NZ), therefore, is relevant to an understanding of the objectives stated in an ISA (NZ) and the proper application of the requirements of an ISA (NZ).

A61. Where necessary, the application and other explanatory material provides further explanation of the requirements of an ISA (NZ) and guidance for carrying them out. In particular, it may:

- Explain more precisely what a requirement means or is intended to cover, including in some ISAs (NZ) such as ISA (NZ) 315 (Revised 2019), why a procedure is required.
- Include examples of procedures that may be appropriate in the circumstances. In some ISAs (NZ), such as ISA (NZ) 315 (Revised 2019), examples are presented in boxes.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an ISA (NZ). The application and other explanatory material may also provide background information on matters addressed in an ISA (NZ).

~~Considerations Specific to Smaller Entities~~ Scalability Considerations

A65a Scalability considerations have been included in some ISAs (NZ) (e.g., ISA (NZ) 315 (Revised 2019)), illustrating the application of the requirements to all entities regardless of whether their nature and circumstances are less complex or more complex. Less complex entities are entities for which the characteristics in paragraph A66 may apply.

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7 ISA (NZ) 315 (Revised 2019), paragraphs 17~~5~~–22~~10~~

8 ISA (NZ) 330; ISA (NZ) 500; ISA (NZ) 520, *Analytical Procedures*; ISA (NZ) 530, *Audit Sampling*

NZ A65b. The "considerations specific to smaller entities" included in some ~~the~~ ISAs (NZ) have been developed primarily with entities that are not FMC reporting entities considered to have a higher level of public accountability in mind. Some of the considerations, however, may be helpful in audits of smaller FMC reporting entities considered to have a higher level of public accountability.

A66. 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) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and

(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 control~~s~~;

(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.

A67 [*Moved – now A65b*]

Considerations Specific to Automated Tools and Techniques

A67a. The considerations specific to "automated tools and techniques" included in some ISAs (NZ) (for example, ISA (NZ) 315 (Revised 2019)) have been developed to explain how the auditor may apply certain requirements when using automated tools and techniques in performing audit procedures.

Objectives Stated in Individual ISAs (NZ) (Ref: Para. 21)

…

A71. In using the objectives, the auditor is required to have regard to the interrelationships among the ISAs (NZ). This is because, as indicated in paragraph A55, the ISAs (NZ) deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this ISA (NZ) requires the auditor to adopt an attitude of professional scepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each ISA (NZ). At a more detailed level, ISA (NZ) 315 (Revised 2019) and ISA (NZ) 330 contain, among other things, objectives and requirements that deal with the auditor's responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An ISA (NZ) dealing with specific aspects of the audit (for example, ISA (NZ) 540 (Revised)) may expand on how the objectives and requirements of such ISAs (NZ) as ISA (NZ) 315 (Revised 2019) and ISA (NZ) 330 are to be applied in relation to the subject of the ISA (NZ) but does not repeat them. Thus, in achieving the objective stated in ISA (NZ) 540 (Revised), the auditor has regard to the objectives and requirements of other relevant ISAs (NZ).

…

Use of Objectives to Determine Need for Additional Audit Procedures (Ref: Para. 21(a))

…

Use of Objectives to Evaluate Whether Sufficient Appropriate Audit Evidence Has Been Obtained (Ref: Para. 21(b))

…

Complying with Relevant Requirements

Relevant Requirements (Ref: Para. 22)

…

Departure from a Requirement (Ref: Para. 23)

…

Failure to Achieve an Objective (Ref: Para. 24)…

ISA (NZ) 210, *Agreeing the Terms of Audit Engagements*

Application and Other Explanatory Material

…

Preconditions for an Audit

…

Agreement of the Responsibilities of Management

...

Internal Control

…

A16. Management maintains such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives due to the inherent limitations of internal control.[9]

A18. It is for management to determine what internal control is necessary to enable the preparation of the financial statements. 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; the entity's process to monitor the system of internal control, 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.[10] 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.

ISA (NZ) 230, *Audit Documentation*

Application and Other Explanatory Material

…

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

…

Form, Content and Extent of Audit Documentation (Ref: Para. 8)

NZA7.1 Audit documentation provides evidence that the audit complies with the ISAs (NZ). However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgement made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- …
- In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
  - For example, there may be no single way in which the auditor's professional scepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional scepticism in accordance with the ISAs (NZ). For example, in relation to accounting estimates, when the audit evidence obtained includes evidence that both corroborates and contradicts management's assertions, documenting how the auditor evaluated that evidence, including the professional judgements made

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9 ISA (NZ) 315 (Revised 2019), "Identifying and Assessing the Risks of Material Misstatement~~ through Understanding the Entity and Its Environment~~," paragraph ~~A46~~Appendix 3 paragraph 22.

10 ISA (NZ) 315 (Revised 2019),~~ ~~paragraph A91~~59~~ and Appendix 3~~1~~

in forming a conclusion as to the sufficiency and appropriateness of the audit evidence obtained.

- ○ Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the ISAs (NZ) may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussions required by ISA (NZ) 315 (Revised 2019).[11]

Documentation of Significant Matters and Related Significant Professional Judgements (Ref: Para. 8(c))

A8. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:

- Matters that give rise to significant risks (as defined in ISA (NZ) 315 (Revised 2019)[12]).

Identification of Specific Items or Matters Tested, and of the Preparer and Reviewer (Ref: Para. 9)

…

Considerations Specific to Smaller Entities (Ref. Para 8)

…

A17. 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 environment, the applicable financial reporting framework, and the entity's system of internal control, the overall audit strategy and audit plan, materiality determined in accordance with ISA (NZ) 320,[13] assessed risks, significant matters noted during the audit, and conclusions reached.

…

Appendix

(Ref: Para. 1)

Specific Audit Documentation Requirements and Guidance in Other ISAs (NZ)

This appendix identifies paragraphs in other ISAs (NZ) that contain specific documentation requirements. The list is not intended to be exhaustive. Furthermore, it is not a substitute for

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11 ISA (NZ) 315 (Revised 2019), "*Identifying and Assessing the Risks of Material Misstatement* ~~through Understanding the Entity and Its Environment~~," paragraph ~~10~~17.

12 ISA (NZ) 315 (Revised 2019), paragraph ~~4(e)~~12(l).

13 ISA (NZ) 320, *Materiality in Planning and Performing an Audit*

considering the requirements and related application and other explanatory material in ISAs (NZ).

- …
- ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~* – paragraph 3~~2~~8

ISA (NZ) 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

Requirements

…

The Auditor's Consideration of Compliance with Laws and Regulations

13. As part of obtaining an understanding of the entity and its environment in accordance with ISA (NZ) 315 (Revised 2019),[14] the auditor shall obtain a general understanding of:

    (a) The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates; and

    (b) How the entity is complying with that framework. (Ref: Para. A11)

Application and Other Explanatory Material

…

Audit Procedures When Non-Compliance is Identified or Suspected

…

Evaluating the Implications of Identified or Suspected Non-Compliance (Ref: Para. 22)

A23. As required by paragraph 22, the auditor evaluates the implications of identified or suspected non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations. The implications of particular identified or suspected non-compliance will depend on the relationship of the perpetration and concealment, if any, of the act to specific controls ~~activities~~ and the level of management or individuals working for, or under the direction of, the entity involved, especially implications arising from the involvement of the highest authority within the entity. As noted in paragraph 9, the auditor's compliance with law, regulation or relevant ethical requirements may provide further information that is relevant to the auditor's responsibilities in accordance with paragraph 22.

…

[14] ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material ~~Misstatement through Understanding the Entity and Its Environment~~*, paragraph ~~11~~19

ISA (NZ) 260 (Revised), *Communication with Those Charged with Governance*

Application and Other Explanatory Material

…

Those Charged with Governance (Ref: Para. 11)

…

A3. Such diversity means that it is not possible for this ISA (NZ) to specify for all audits the person(s) with whom the auditor is to communicate particular matters. Also, in some cases, the appropriate person(s) with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organisations, and some government entities. In such cases, the auditor may need to discuss and agree with the engaging party the relevant person(s) with whom to communicate. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with ISA (NZ) 315 (Revised 2019)[15] is relevant. The appropriate person(s) with whom to communicate may vary depending on the matter to be communicated.

…

Matters to Be Communicated

…

Planned Scope and Timing of the Audit (Ref: Para. 15)

…

A12. Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they were determined to be significant risks ~~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.

A13**.** Matters communicated may include: …

- How the auditor plans to address the significant risks of material misstatement, whether due to fraud or error.
- How the auditor plans to address areas of higher assessed risks of material misstatement.
- The auditor's approach to the entity's system of internal control. ~~relevant to the audit.~~

[15] ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement* ~~*through Understanding the Entity and Its Environment*~~*.*

- The application of the concept of materiality in the context of an audit.
- …

The Communication Process

…

Adequacy of the Communication Process (Ref: Para. 22)

…

A52. As noted in paragraph 4, effective two-way communication assists both the auditor and those charged with governance. Further, ISA (NZ) 315 (Revised 2019) identifies participation by those charged with governance, including their interaction with internal audit, if any, and external auditors, as an element of the entity's control environment.[16] Inadequate two-way communication may indicate an unsatisfactory control environment and influence the auditor's assessment of the risks of material misstatements. There is also a risk that the auditor may not have obtained sufficient appropriate audit evidence to form an opinion on the financial statements.

Appendix 2 (Ref: Para. 16(a), A19–A20)

Qualitative Aspects of Accounting Practices

The communication required by paragraph 16(a), and discussed in paragraphs A19–A20, may include such matters as:

…

Accounting Estimates

- For items for which estimates are significant, issues discussed in ISA (NZ) 540,[1] including, for example:
  - How management identifies those transactions, events ~~and~~ or conditions that may give rise to the need for accounting estimates to be recognised or disclosed in the financial statements.

…

ISA (NZ) 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance*

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements. This ISA (NZ) does not impose additional responsibilities on the auditor

[16] ISA (NZ) 315 (Revised 2019), ~~paragraph A77~~Appendix 3.

regarding obtaining an understanding of the entity's system of internal control and designing and performing tests of controls over and above the requirements of ISA (NZ) 315 (Revised 2019)[17] and ISA (NZ) 330. ISA (NZ) 260 (Revised) establishes further requirements and provides guidance regarding the auditor's responsibility to communicate with those charged with governance in relation to the audit.

2. The auditor is required to obtain an understanding of the entity's system of internal control ~~relevant to the audit~~ when identifying and assessing the risks of material misstatement.[4] In making those risk assessments, the auditor considers the entity's system of internal control in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The auditor may identify control deficiencies in internal control not only during this risk assessment process but also at any other stage of the audit. This ISA (NZ) specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management.

…

Application and Other Explanatory Material

Determination of Whether Deficiencies in Internal Control Have Been Identified (Ref: Para 7)

…

Considerations Specific to Smaller Entities

A3. While the concepts underlying controls in the control activities component 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~~.

…

Significant Deficiencies in Internal Control (Ref: Para. 6(b), 8)

A8. Controls may be designed to operate individually or in combination to effectively prevent, or detect and correct, misstatements.[18] For example, controls over accounts receivable may consist of both automated and manual controls designed to operate together to prevent, or detect and correct, misstatements in the account balance. 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 the entity's system of internal control may increase the risks of misstatement to such an extent as to give rise to a significant deficiency.

[17] ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement,* paragraphs ~~4~~ 12 and ~~12~~21

[18] ISA (NZ) 315 (Revised 2019), paragraph ~~A66~~A175.

ISA (NZ) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how ISA (NZ) 315 (Revised 2019)[19] and ISA (NZ) 330[20] are to be applied in relation to risks of material misstatement due to fraud.

…

Characteristics of Fraud

…

Responsibility for the Prevention and Detection of Fraud

…

Responsibilities of the Auditor

…

7. 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.

…

Effective Date

…

Objectives

…

Definitions

…

Requirements

Professional Scepticism

13. In accordance with ISA (NZ) 200,[21] the auditor shall maintain professional scepticism throughout the audit, recognising the possibility that a material misstatement due to fraud could

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[19] ISA (NZ) 315 (Revised 2019), "Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~."

[20] ISA (NZ) 330, "The Auditor's Responses to Assessed Risks."

[21] ISA (NZ) 200, paragraph 15

exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance. (Ref: Para. A8–A9)

14. Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref: Para. A10)

15. Where responses to enquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.

Discussion among the Engagement Team

16. ISA (NZ) 315 (Revised 2019) requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.[22] This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity. (Ref: Para. A11–A12)

Risk Assessment Procedures and Related Activities

17. 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 ISA (NZ) 315 (Revised 2019),[23] the auditor shall perform the procedures in paragraphs 23~~18~~–43~~25~~ to obtain information for use in identifying the risks of material misstatement due to fraud.

Management and Others within the Entity

…

Those Charged with Governance

21. Unless all of those charged with governance are involved in managing the entity,[24] 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)

…

Unusual or Unexpected Relationships Identified

…

Other Information

22 ISA (NZ) 315 (Revised 2019), paragraph 17–18 ~~10~~

~~23 ISA (NZ) 315 (Revised), paragraphs 5–24~~

24 ISA (NZ) 260 (Revised), *Communication with Those Charged with Governance*, paragraph 13

24. The auditor shall consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud. (Ref: Para. A22)

Evaluation of Fraud Risk Factors

25. The auditor shall evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. While fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud. (Ref: Para. A24–A28)

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

26. In accordance with ISA (NZ) 315 (Revised 2019), the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.[25]

27. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 47 specifies the documentation required where the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Ref: Para. A29–A31)

28. 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, and evaluate their design and determine whether they have been implemented).[26] (Ref: Para. A32–A33)

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses

…

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level

…

Audit Procedures Responsive to Risks Related to Management Override of Controls

…

33. Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:

    (a) Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall:

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25 ISA (NZ) 315 (Revised 2019), paragraph 28~~2~~

26 ISA (NZ) 315 (Revised 2019), paragraph 26(a)(i) and 26(d)

(i) Make enquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;

(ii) Select journal entries and other adjustments made at the end of a reporting period; and

(iii) Consider the need to test journal entries and other adjustments throughout the period. (Ref: Para. A42–A45)

…

Evaluation of Audit Evidence (Ref: Para. A50)

…

Auditor Unable to Continue the Engagement

…

Written Representations

…

Communications to Management and with Those Charged with Governance

…

Reporting Fraud to an Appropriate Authority Outside the Entity

…

Documentation

45. The auditor shall include the following in the audit documentation[27] ~~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 ISA (NZ) 315 (Revised 2019):[28]

(a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud; ~~and~~

(b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level;~~.~~ and

(c) Identified controls in the control activities component that address assessed risks of material misstatement due to fraud.

…

Application and Other Explanatory Material

Characteristics of Fraud (Ref: Para. 3)

…

27 ISA (NZ) 230, *Audit Documentation*, paragraphs 8–11, and paragraph A6

28 ISA (NZ) 315 (Revised 2019), paragraph 38~~32~~

Professional Scepticism (Ref: Para. 13–15)

A8. 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~~ identified controls in the control activities component, if any, over its preparation and maintenance. ~~where relevant.~~ Due to the characteristics of fraud, the auditor's professional scepticism is particularly important when considering the risks of material misstatement due to fraud.

…

Discussion Among the Engagement Team *(Ref: Para. 16)*

…

Risk Assessment Procedures and Related Activities

Enquiries of Management

Management's Assessment of the Risk of Material Misstatement Due to Fraud (Ref: Para. 18(a))

…

Enquiry of Internal Audit (Ref: Para. 20)

A19. ISA (NZ) 315 (Revised 2019) and ISA (NZ) 610 (Revised 2013) establish requirements and provide guidance relevant to audits of those entities that have an internal audit function.[29] In carrying out the requirements of those ISAs (NZ) in the context of fraud, the auditor may inquire about specific activities of the function including, for example:

- The procedures performed, if any, by the internal auditor function during the year to detect fraud.
- Whether management has satisfactorily responded to any findings resulting from those procedures.

Obtaining an Understanding of Oversight Exercised by Those Charged with Governance (Ref: Para. 21)

A20. Those charged with governance of an entity oversee the entity's systems for monitoring risk, financial control and compliance with the law. In many countries, 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 country, 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.[30]

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29 ISA (NZ) 315 (Revised 2019), paragraphs 14(a) and 24(a)(ii)~~6 and 23~~, and ISA (NZ) 610 (Revised 2013), *Using the Work of Internal Auditors*

30 ISA (NZ) 260 (Revised), paragraphs A1–A8, discuss with whom the auditor communicates when the entity's governance structure is not well defined.

A21. 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 inquiries of those charged with governance.

Considerations Specific to Smaller Entities

…

Consideration of Other Information (Ref: Para. 24)

A23. 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.

Evaluation of Fraud Risk Factors (Ref: Para. 25)

…

A26. 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 may relate to incentives, pressures or opportunities that arise from conditions that create susceptibility to misstatement, before consideration of controls. Fraud risk factors, which include intentional management bias, are, insofar as they affect inherent risk, inherent risk factors.[31] Fraud risk factors may also 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. Fraud r~~R~~isk 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.[32] 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.

…

31 ISA (NZ) 315 (Revised 2019), paragraph 12(f)

32 ISA (NZ) 315 (Revised 2019), paragraph 21

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

Risks of Fraud in Revenue Recognition (Ref: Para. 27)

…

Identifying and Assessing the Risks of Material Misstatement Due to Fraud and Understanding the Entity's Related Controls (Ref: Para. 28)

A31. Management may make judgements on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume. In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud. As part of this consideration, management may conclude that it is not cost effective to implement and maintain a particular control in relation to the reduction in the risks of material misstatement due to fraud to be achieved.

A32. 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 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 statements may contain material misstatement due to fraud.

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses (Ref: Para. 29)

…

Assignment and Supervision of Personnel (Ref: Para. 30(a))

…

Unpredictability in the Selection of Audit Procedures (Ref: Para. 30(c))

…

*Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level (*Ref: Para. 31)

…

Audit Procedures Responsive to Risks Related to Management Override of Controls

Journal Entries and Other Adjustments (Ref: Para. 33(a))

…

A43. Further, the auditor's consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries[33] is important since automated

[33] ISA (NZ) 315 (Revised 2019), paragraph 26(a)(ii)

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.

A44. 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 statements 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* – non standard 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.

…

Accounting Estimates *(Ref: Para. 33(b))*

…

Business Rationale for Significant Transactions *(Ref: Para. 33(c))*

…

Evaluation of Audit Evidence (Ref: Para. 35–38)

…

Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion (Ref: Para. 35)

…

Consideration of Identified Misstatements (Ref: Para. 36–38)

…

Auditor Unable to Continue the Engagement (Ref: Para. 39)

…

Written Representations (Ref: Para. 40)

…

Communications to Management and with Those Charged with Governance

Communication to Management (Ref: Para. 41)

…

Communication with Those Charged with Governance (Ref: Para. 42)

…

Other Matters Related to Fraud (Ref: Para. 43)

…

Reporting Fraud to an Appropriate Authority Outside the Entity (Ref: Para. 44)

…

Appendix 1

(Ref: Para. A26)

Examples of Fraud Risk Factors

The fraud risk factors identified in this Appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration – that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives/pressures, (b) opportunities, and (c) attitudes/rationalisations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Fraud risk factors may relate to incentives or pressures, or opportunities, that arise from conditions that create susceptibility to misstatement before consideration of controls (i.e., the inherent risk). Such factors are inherent risk factors, insofar as they affect inherent risk, and may be due to management bias. Fraud risk factors related to opportunities may also arise from other identified inherent risk factors (for example, 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.

Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

Incentives/Pressures

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

…

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

…

Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:

…

Opportunities

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

…

The monitoring of management is not effective as a result of the following:

…

There is a complex or unstable organisational structure, as evidenced by the following:

…

~~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.

Attitudes/Rationalisations

...

Risk Factors Arising from Misstatements Arising from Misappropriation of Assets

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalisation. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

Incentives/Pressures

…

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

…

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:

- Inadequate segregation of duties or independent checks.
- Inadequate oversight of senior management expenditures, such as travel and other re-imbursements.
- Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- Inadequate job applicant screening of employees with access to assets.
- Inadequate record keeping with respect to assets.
- Inadequate system of authorisation and approval of transactions (for example, in purchasing).
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets.

- Lack of complete and timely reconciliations of assets.
- Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- Inadequate access controls over automated records, including controls over and review of computer systems event logs.

Attitudes/Rationalisations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- 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.
- Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behaviour or lifestyle that may indicate assets have been misappropriated.
- Tolerance of petty theft.

Appendix 2

(Ref: Para. A41)

Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly they may not be the most appropriate nor necessary in each circumstance. Also the order of the procedures provided is not intended to reflect their relative importance.

Consideration at the Assertion Level

Specific responses to the auditor's assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures and assertions they may affect.

The following are specific examples of responses:

…

- 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.

…

Specific Responses—Misstatement Resulting from Fraudulent Financial Reporting

Examples of responses to the auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

…

Appendix 3

(Ref: Para. A50)

Examples of Circumstances that Indicate the Possibility of Fraud

The following are examples of circumstances that may indicate the possibility that the financial statements may contain a material misstatement resulting from fraud.

…

ISA (NZ) 300, *Planning an Audit of Financial Statements*

Requirements

…9. The auditor shall develop an audit plan that shall include a description of:

(a) The nature, timing and extent of planned risk assessment procedures, as determined under ISA (NZ) 315 (Revised 2019).[34]

(b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under ISA (NZ) 330.[35]

(c) Other planned audit procedures that are required to be carried out so that the engagement complies with ISAs (NZ). (Ref: Para. A12-A14)

Application and Other Explanatory Material

…

Involvement of Key Engagement Team Members (Ref: Para. 5)

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[34] ISA (NZ) 315 (Revised 2019), "Identifying and Assessing the Risks of Material Misstatements ~~through Understanding the Entity and Its Environment~~."

[35] ISA (NZ) 330, "The Auditor's Responses to Assessed Risks."

A4. The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process[36].

…

Documentation (Ref: Para. 12)

...

Considerations Specific to Smaller Entities

A21. As discussed in paragraph A11, a suitable, brief memorandum may serve as the documented strategy for the audit of a smaller entity. For the audit plan, standard audit programs or checklists (see paragraph A19) drawn up on the assumption of few ~~relevant~~ controls[37] ~~activities~~, as is likely to be the case in a smaller entity, may be used provided that they are tailored to the circumstances of the engagement, including the auditor's risk assessments.

…

ISA (NZ) 402, *Audit Considerations Relating to an Entity Using a Service Organisation*

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organisations. Specifically, it expands on how the user auditor applies ISA (NZ) 315 (Revised 2019)[38] and ISA (NZ) 330 in obtaining an understanding of the user entity, including the entity's system of internal control relevant to the preparation of the financial statements ~~relevant to the audit~~, sufficient to identify and assess the risks of material misstatement and in designing and performing further audit procedures responsive to those risks.

…

3. Services provided by a service organisation are relevant to the audit of a user entity's financial statements 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~~ the preparation of the financial statements. ~~Although m~~ Most controls at the service organisation are likely to ~~relate to financial reporting~~ be part of the user entity's information

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[36] ISA (NZ) 315 (Revised 2019), paragraph 17~~0~~ establishes requirements and provides guidance on the engagement team's discussion of the susceptibility of the entity's financial statements to material misstatements ~~of the financial statements~~. ISA (NZ) 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraph 15 provides guidance on the emphasis given during this discussion to the susceptibility of the entity's financial statements to material misstatement due to fraud.

[37] ISA (NZ) 315 (Revised 2019), paragraph 26(a)

[38] ISA (NZ) 315 (Revised 2019), "Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~."

system relevant to the preparation of the financial statements, ~~there may be other~~ or related 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 statements;~~ 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 statements;~~ 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 statements; and

(ii) Information about events or conditions, other than transactions, is captured, processed and disclosed by the user entity in the financial statements.

(b) ~~(c)~~ The ~~related~~ accounting records, ~~either in electronic or manual form, supporting information and~~ specific accounts in the user entity's financial statements 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 statements;~~

(c~~e~~) The financial reporting process used to prepare the user entity's financial statements 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.~~

…

Objectives

7. The objectives of the user auditor, when the user entity uses the services of a service organisation, are:

(a) To obtain an understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's system of internal control ~~relevant to the audit~~, sufficient to provide an appropriate basis for the identification and assessment of ~~identify and assess~~ the risks of material misstatement; and

(b) To design and perform audit procedures responsive to those risks.

…

Requirements

Obtaining an Understanding of the Services Provided by a Service Organisation, Including Internal Control

9. When obtaining an understanding of the user entity in accordance with ISA (NZ) 315 (Revised 2019),[39] the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including: (Ref: Para. A1-A2)

   (a) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control; (Ref: Para. A3-A5)

   (b) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation; (Ref: Para. A6)

   (c) The degree of interaction between the activities of the service organisation and those of the user entity; and (Ref: Para. A7)

   (d) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation. (Ref: Para. A8-A11)

10. When obtaining an understanding of the entity's system of internal control ~~relevant to the audit~~ in accordance with ISA (NZ) 315 (Revised 2019),~~[40]~~ the user auditor shall identify controls in the control activities component[41] ~~evaluate the design and implementation of relevant controls~~ at the user entity, from those that relate to the services provided by the service organisation, including those that are applied to the transactions processed by the service organisation, and evaluate their design and determine whether they have been implemented.[42] (Ref: Para. A12–A14)

11. The user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the service organisation and their effect on the user entity's system of internal control ~~relevant to the audit~~ has been obtained to provide an appropriate basis for the identification and assessment of the risks of material misstatement.

12. If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor shall obtain that understanding from one or more of the following procedures:

   …

   (c) Visiting the service organisation and performing procedures that will provide the necessary information about the relevant controls at the service organisation; or

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39 ISA (NZ) 315 (Revised 2019), paragraph ~~11~~19.

~~40 ISA (NZ) 315 (Revised), paragraph 12~~

41 ISA (NZ) 315 (Revised 2019), paragraphs 26(a)

42 ISA (NZ) 315 (Revised 2019), paragraph 26(d)

(d) Using another auditor to perform procedures that will provide the necessary information about ~~the relevant~~ controls at the service organisation. (Ref: Para. A15–A20)

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organisation

...

14. If the user auditor plans to use a type 1 or type 2 report as audit evidence to support the user auditor's understanding about the design and implementation of controls at the service organisation, the user auditor shall:

…

(b) Evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the ~~user entity's internal~~ controls at the service organisation ~~relevant to the audit~~; and

…

Application and Other Explanatory Material

Obtaining an Understanding of the Services Provided by a Service Organisation, Including Internal Control

…

Understanding the Controls Relating to Services Provided by the Service Organisation (Ref: Para. 10)

…

A14. As noted in ISA (NZ) 315 (Revised 2019),[43] in respect of some risks, the user auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions and account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. Such automated processing characteristics may be particularly present when the user entity uses service organisations. In such cases, the user entity's controls over such risks are relevant to the audit and the user auditor is required to obtain an understanding of, and to evaluate, such controls in accordance with paragraphs 9 and 10 of this ISA (NZ).

Further Procedures When a Sufficient Understanding Cannot Be Obtained from the User Entity (Ref: Para. 12)

…

A19. Another auditor may be used to perform procedures that will provide the necessary information about the relevant–controls at the service organisation related to services provided to the user entity. If a type 1 or type 2 report has been issued, the user auditor may

43 ISA (NZ) 315 (Revised 2019), paragraph ~~30~~26(a)(iii).

use the service auditor to perform these procedures as the service auditor has an existing relationship with the service organisation. The user auditor using the work of another auditor may find the guidance in ISA (NZ) 600 useful as it relates to understanding another auditor (including that auditor's independence and professional competence), involvement in the work of another auditor in planning the nature, timing and extent of such work, and in evaluating the sufficiency and appropriateness of the audit evidence obtained.

…

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organisation (Ref: Para. 13–14)

…

A22. A type 1 or type 2 report, along with information about the user entity, may assist the user auditor in obtaining an understanding of:

(a) The aspects of controls at the service organisation that may affect the processing of the user entity's transactions, including the use of subservice organisations;

(b) The flow of significant transactions through the service organisation to determine the points in the transaction flow where material misstatements in the user entity's financial statements could occur;

(c) The control objectives at the service organisation that are relevant to the user entity's financial statement assertions; and

(d) Whether controls at the service organisation are suitably designed and implemented to prevent, or detect and correct processing errors that could result in material misstatements in the user entity's financial statements.

A type 1 or type 2 report may assist the user auditor in obtaining a sufficient understanding to identify and assess the risks of material misstatement. A type 1 report, however, does not provide any evidence of the operating effectiveness of the ~~relevant~~ controls.

Responding to the Assessed Risks of Material Misstatement

...

Test of Controls

A29. The user auditor is required by ISA (NZ) 330 to design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls in certain circumstances. In the context of a service organisation, this requirement applies when:

…

A30. If a type 2 report is not available, a user auditor may contact the service organisation, through the user entity, to request that a service auditor be engaged to provide a type 2 report that includes tests of the operating effectiveness of the ~~relevant~~ controls or the user auditor may use another auditor to perform procedures at the service organisation that test the operating effectiveness of those controls. A user auditor may also visit the service organisation and perform tests of ~~relevant~~ controls if the service organisation agrees to it. The user auditor's risk assessments are based on the combined evidence provided by the work of another auditor and the user auditor's own procedures.

Using a Type 2 Report as Audit Evidence that Controls at the Service Organisation Are Operating Effectively

…

A33. It may also be necessary for the user auditor to obtain additional evidence about significant changes to the ~~relevant~~ controls at the service organisation outside of the period covered by the type 2 report or determine additional audit procedures to be performed. Relevant factors in determining what additional audit evidence to obtain about controls at the service organisation that were operating outside of the period covered by the service auditor's report may include:

…

- The effectiveness of the control environment and the user entity's process to monitor the system of internal control ~~monitoring of controls at the user entity~~.

A34. Additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the user entity's process to monitor the system of internal control ~~monitoring of controls~~.

…

A39. The user auditor is required to communicate in writing significant deficiencies identified during the audit to both management and those charged with governance on a timely basis.[11] The user auditor is also required to communicate to management at an appropriate level of responsibility on a timely basis other deficiencies in internal control identified during the audit that, in the user auditor's professional judgement, are of sufficient importance to merit management's attention.[12] Matters that the user auditor may identify during the audit and may communicate to management and those charged with governance of the user entity include:

- Any controls within the entity's process to monitor the system of internal control ~~monitoring of controls~~ that could be implemented by the user entity, including those identified as a result of obtaining a type 1 or type 2 report;

…

ISA (NZ) 330, *The Auditor's Responses to Assessed Risks*

Introduction

(a) Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with ISA (NZ) 315 (Revised 2019)[44] in an audit of financial statements.

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44 ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~*

Effective Date

2. This ISA (NZ) is effective for audits of financial statements for periods beginning on or after December 15, 2009.

Objective

3. The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks.

Definitions

4. For purposes of the ISAs (NZ), the following terms have the meanings attributed below:

   (a) Substantive procedure – An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:

      (i) Tests of details (of classes of transactions, account balances, and disclosures); and

      (ii) Substantive analytical procedures.

   (b) Test of controls – An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Requirements

Overall Responses

5. The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. (Ref: Para. A1–A3)

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

6. 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)

7. 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~~plans to test 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)

Tests of Controls

8. 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) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (that is, the auditor ~~intends~~ plans to test ~~to rely on~~ the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or

(b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. (Ref: Para. A20–A24)

9. In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. (Ref: Para. A25)

Nature and Extent of Tests of Controls

10. 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)

Timing of Tests of Controls

11. The auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls, subject to paragraphs 12 and 15 below, in order to provide an appropriate basis for the auditor's intended reliance. (Ref: Para. A32)

Using audit evidence obtained during an interim period

12. If the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor shall:

(a) Obtain audit evidence about significant changes to those controls subsequent to the interim period; and

(b) Determine the additional audit evidence to be obtained for the remaining period. (Ref: Para. A33–A34)

Using audit evidence obtained in previous audits

13. 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 monitor~~ing~~ ~~of~~ the system of internal control~~s~~, and the entity's risk assessment process;

(b) The risks arising from the characteristics of the control, including whether it is manual or automated;

(c) The effectiveness of general IT controls;

(d) The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control;

(e) Whether the lack of a change in a particular control poses a risk due to changing circumstances; and

(f) The risks of material misstatement and the extent of reliance on the control. (Ref: Para. A35)

14. 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) If there have been changes that affect the continuing relevance of the audit evidence from the previous audit, the auditor shall test the controls in the current audit. (Ref: Para. A36)

(b) If there have not been such changes, the auditor shall test the controls at least once in every third audit, and shall test some controls each audit to avoid the possibility of testing all the controls on which the auditor intends to rely in a single audit period with no testing of controls in the subsequent two audit periods. (Ref: Para. A37–A39)

Controls over significant risks

15. If the auditor ~~plans~~ intends to rely ~~test~~ on controls over a risk the auditor has determined to be a significant risk, the auditor shall test those controls in the current period.

Evaluating the Operating Effectiveness of Controls

16. 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)

17. If deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries 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.

Substantive Procedures

18. 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. (Ref: Para. A42–A47)

19. The auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures. (Ref: Para. A48–A51)

Substantive Procedures Related to the Financial Statement Closing Process

20. The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process:

    (a) Agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers; and

    (b) Examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: Para. A52)

Substantive Procedures Responsive to Significant Risks

21. If the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details. (Ref: Para. A53)

Timing of Substantive Procedures

22. If substantive procedures are performed at an interim date, the auditor shall cover the remaining period by performing:

    (a) substantive procedures, combined with tests of controls for the intervening period; or

    (b) if the auditor determines that it is sufficient, further substantive procedures only,

    that provide a reasonable basis for extending the audit conclusions from the interim date to the period end. (Ref: Para. A54–A57)

23. If misstatements that the auditor did not expect when assessing the risks of material misstatement are detected at an interim date, the auditor shall evaluate whether the related assessment of risk and the planned nature, timing or extent of substantive procedures covering the remaining period need to be modified. (Ref: Para. A58)

Adequacy of Presentation of the Financial Statements

24. The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework. In making this evaluation, the auditor shall consider whether the financial statements are presented in a manner that reflects the appropriate:

- Classification and description of financial information and the underlying transactions, events and conditions; and
- Presentation, structure and content of the financial statements. (Ref: Para. A59)

Evaluating the Sufficiency and Appropriateness of Audit Evidence

25. Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate before the conclusion of the audit whether the assessments of the risks of material misstatement at the assertion level remain appropriate. (Ref: Para. A60–A61)

26. The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. (Ref: Para. A62)

27. If the auditor has not obtained sufficient appropriate audit evidence ~~as to~~ related to a~~n~~ ~~material financial statement~~ 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 statements.

Documentation

28. The auditor shall include in the audit documentation:[45]

    (a) The overall responses to address the assessed risks of material misstatement at the financial statement level, and the nature, timing and extent of the further audit procedures performed;

    (b) The linkage of those procedures with the assessed risks at the assertion level; and

    (c) The results of the audit procedures, including the conclusions where these are not otherwise clear. (Ref: Para. A63)

29. If the auditor plans to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor shall include in the audit documentation the conclusions reached about relying on such controls that were tested in a previous audit.

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45 ISA (NZ) 230, *Audit Documentation*, paragraphs 8–11, and A6

30. The auditor's documentation shall demonstrate that information in the financial statements agrees or reconciles with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers.

Application and Other Explanatory Material

Overall Responses (Ref: Para. 5)

A1. Overall responses to address the assessed risks of material misstatement at the financial statement 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 ISA (NZ) 300, or planned audit procedures, and may include changes to:
    - The auditor's determination of performance materiality in accordance with ISA (NZ) 320.
    - The auditor's plans to test~~s~~ 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 statements 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~~.

A2. The assessment of the risks of material misstatement at the financial statement level, and thereby the auditor's overall responses, is affected by the auditor's understanding of the control environment. An effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity and thus, for example, allow the auditor to conduct some audit procedures at an interim date rather than at the period end. Deficiencies in the control environment, however, have the opposite effect; for example, the auditor may respond to an ineffective control environment by:

- Conducting more audit procedures as of the period end rather than at an interim date.
- Obtaining more extensive audit evidence from substantive procedures.
- Increasing the number of locations to be included in the audit scope.

A3. Such considerations, therefore, have a significant bearing on the auditor's general approach, for example, an emphasis on substantive procedures (substantive approach), or an approach that uses tests of controls as well as substantive procedures (combined approach).

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

The Nature, Timing and Extent of Further Audit Procedures (Ref: Para. 6)

A4. 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) Only by performing tests of controls may the auditor achieve an effective response to the assessed risk of material misstatement for a particular assertion;

(b) Performing only substantive procedures is appropriate for particular assertions and, therefore, the auditor excludes the effect of controls from the ~~relevant risk~~ assessment of the risk of material misstatement. This may be because the ~~auditor's risk assessment procedures have not identified any effective controls relevant to the assertion, or because~~ auditor has not identified a risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence and therefore is not required to test the operating effectiveness of controls. ~~testing controls would be inefficient and~~ T~~t~~herefore, the auditor ~~does~~ may not ~~intend to rely on~~ plan to test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures; or

(c) A combined approach using both tests of controls and substantive procedures is an effective approach.

The auditor need not design and perform further audit procedures where the assessment of the risk of material misstatement is below the acceptably low level. However, as required by paragraph 18, irrespective of the approach selected and the assessed risk of material misstatement, the auditor designs and performs substantive procedures for each material class of transactions, account balance, and disclosure.

A5. The nature of an audit procedure refers to its purpose (that is, test of controls or substantive procedure) and its type (that is, inspection, observation, enquiry, confirmation, recalculation, reperformance, or analytical procedure). The nature of the audit procedures is of most importance in responding to the assessed risks.

A6. Timing of an audit procedure refers to when it is performed, or the period or date to which the audit evidence applies.

A7. Extent of an audit procedure refers to the quantity to be performed, for example, a sample size or the number of observations of a control ~~activity~~.

A8. Designing and performing 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 provides a clear linkage between the auditor's further audit procedures and the risk assessment.

Responding to the Assessed Risks at the Assertion Level (Ref: Para. 7(a))

Nature

A9. ISA (NZ) 315 (Revised 2019) 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 misstatement taking into account how, and the degree to which the inherent risk factors affect the susceptibility to misstatement of relevant assertions.[46] 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.

A10. 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 auditor plans to test 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.

Timing

A11. The auditor may perform tests of controls or substantive procedures at an interim date or at the period end. The higher the risk of material misstatement, the more likely it is that the auditor may decide it is more effective to perform substantive procedures nearer to, or at, the period end rather than at an earlier date, or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis). This is particularly relevant when considering the response to the risks of fraud. For example, the auditor may conclude that, when the risks of intentional misstatement or manipulation have been identified, audit procedures to extend audit conclusions from interim date to the period end would not be effective.

A12. On the other hand, performing audit procedures before the period end may assist the auditor in identifying significant matters at an early stage of the audit, and consequently resolving them with the assistance of management or developing an effective audit approach to address such matters.

A13. In addition, certain audit procedures can be performed only at or after the period end, for example:

- Agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers;

[46] ISA (NZ) 315 (Revised 2019), paragraphs 31 and 34

- Examining adjustments made during the course of preparing the financial statements; and
- Procedures to respond to a risk that, at the period end, the entity may have entered into improper sales contracts, or transactions may not have been finalised.

A14. Further relevant factors that influence the auditor's consideration of when to perform audit procedures include the following:

- The control environment.
- When relevant information is available (for example, electronic files may subsequently be overwritten, or procedures to be observed may occur only at certain times).
- The nature of the risk (for example, if there is a risk of inflated revenues to meet earnings expectations by subsequent creation of false sales agreements, the auditor may wish to examine contracts available on the date of the period end).
- The period or date to which the audit evidence relates.
- The timing of the preparation of the financial statements, particularly for those disclosures that provide further explanation about amounts recorded in the statement of financial position, the statement of comprehensive income, the statement of changes in equity or the statement of cash flows.

Extent

A15. The extent of an audit procedure judged necessary is determined after considering the materiality, the assessed risk, and the degree of assurance the auditor plans to obtain. When a single purpose is met by a combination of procedures, the extent of each procedure is considered separately. In general, the extent of audit procedures increases as the risk of material misstatement increases. For example, in response to the assessed risk of material misstatement due to fraud, increasing sample sizes or performing substantive analytical procedures at a more detailed level may be appropriate. However, increasing the extent of an audit procedure is effective only if the audit procedure itself is relevant to the specific risk.

A16. The use of computer-assisted audit techniques (CAATs) may enable more extensive testing of electronic transactions and account files, which may be useful when the auditor decides to modify the extent of testing, for example, in responding to the risks of material misstatement due to fraud. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, or to test an entire population instead of a sample.

Considerations specific to public sector entities

A17. For the audits of public sector entities, the audit mandate and any other special auditing requirements may affect the auditor's consideration of the nature, timing and extent of further audit procedures.

Considerations specific to smaller entities

A18. In the case of very small 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.

Higher Assessments of Risk (Ref: Para 7(b))

A19. When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.

Tests of Controls

Designing and Performing Tests of Controls (Ref: Para. 8)

A20. 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 a~~n~~ relevant assertion, and the auditor plans to test those controls. If substantially different controls were used at different times during the period under audit, each is considered separately.

A21. Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls. However, the same types of audit procedures are used. The auditor may, therefore, decide it is efficient to test the operating effectiveness of controls at the same time as evaluating their design and determining that they have been implemented.

A22. Further, although some risk assessment procedures may not have been specifically designed as tests of controls, they may nevertheless provide audit evidence about the operating effectiveness of the controls and, consequently, serve as tests of controls. For example, the auditor's risk assessment procedures may have included:

- Inquiring about management's use of budgets.
- Observing management's comparison of monthly budgeted and actual expenses.
- Inspecting reports pertaining to the investigation of variances between budgeted and actual amounts.

These audit procedures provide knowledge about the design of the entity's budgeting policies and whether they have been implemented, but may also provide audit evidence about the effectiveness of the operation of budgeting policies in preventing or detecting material misstatements in the classification of expenses.

A23. In addition, the auditor may design a test of controls to be performed concurrently with a test of details on the same transaction. Although the purpose of a test of controls is different from the purpose of a test of details, both may be accomplished concurrently by performing a test of controls and a test of details on the same transaction, also known as a dual-purpose test. For example, the auditor may design, and evaluate the results of, a test to examine an invoice to determine whether it has been approved and to provide substantive audit evidence of a transaction. A dual-purpose test is designed and evaluated by considering each purpose of the test separately.

A24. 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.[47] 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.

Audit Evidence and Intended Reliance (Ref: Para. 9)

A25. A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

Nature and Extent of Tests of Controls

Other audit procedures in combination with enquiry (Ref: Para. 10(a))

A26. Enquiry alone is not sufficient to test the operating effectiveness of controls. Accordingly, other audit procedures are performed in combination with enquiry. In this regard, enquiry combined with inspection or reperformance may provide more assurance than enquiry and observation, since an observation is pertinent only at the point in time at which it is made.

A27. 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.

Extent of tests of controls

A28. When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control. As well as the degree of reliance on controls, matters the auditor may consider in determining the extent of tests of controls include the following:

- The frequency of the performance of the control by the entity during the period.
- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
- The expected rate of deviation from a control.
- The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.

[47] ISA (NZ) 315 (Revised 2019), paragraph 33~~30~~

- The extent to which audit evidence is obtained from tests of other controls related to the assertion.

ISA (NZ) 530[48] contains further guidance on the extent of testing.

A29. 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 control~~s~~ 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.~~

A29a. 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 of material misstatement 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).

A29b. 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 ISA (NZ) 315 (Revised 2019)[49] to provide the basis for the design of the auditor's additional procedures to address the assessed risk of material misstatement. 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 identify such controls (if not already identified) 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

48 ISA (NZ) 530, *Audit Sampling*

49 ISA (NZ) 315 (Revised 2019), paragraph 26(c)(i)

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).

Testing of indirect controls (Ref: Para. 10(b))

A30. 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 identified in accordance with ISA (NZ) 315 (Revised 2019) 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.~~

~~A31. Because of the inherent consistency of IT processing, audit evidence about the implementation of an automated application control, when considered in combination with audit evidence about the operating effectiveness of the entity's general controls (in particular, change controls), may also provide substantial audit evidence about its operating effectiveness.~~

Timing of Tests of Controls

Intended period of reliance (Ref: Para. 11)

A32. 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 monitor~~ing~~ ~~of~~ the system of internal controls.

Using audit evidence obtained during an interim period (Ref: Para. 12(b))

A33. Relevant factors in determining what additional audit evidence to obtain about controls that were operating during the period remaining after an interim period, include:

- The significance of the assessed risks of material misstatement at the assertion level.
- The specific controls that were tested during the interim period, and significant changes to them since they were tested, including changes in the information system, processes, and personnel.
- The degree to which audit evidence about the operating effectiveness of those controls was obtained.

- The length of the remaining period.
- The extent to which the auditor intends to reduce further substantive procedures based on the reliance of controls.
- The control environment.

A34. Additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the entity's monitoring of controls.

Using audit evidence obtained in previous audits (Ref: Para. 13)

A35. 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, inquiries 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.

Controls that have changed from previous audits (Ref: Para. 14(a))

A36. 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.

Controls that have not changed from previous audits (Ref: Para. 14(b))

A37. The auditor's decision on whether to rely on audit evidence obtained in previous audits for controls that:

(a) have not changed since they were last tested; and

(b) are not controls that mitigate a significant risk,

is a matter of professional judgement. In addition, the length of time between retesting such controls is also a matter of professional judgement, but is required by paragraph 14 (b) to be at least once in every third year.

A38. 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 ~~D~~deficiency~~t~~ in the entity's process to monitor~~ing of~~ the system of internal control~~s~~.
- 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.

A39. When there are a number of controls for which the auditor intends to rely on audit evidence obtained in previous audits, testing some of those controls in each audit provides corroborating information about the continuing effectiveness of the control environment. This contributes to the auditor's decision about whether it is appropriate to rely on audit evidence obtained in previous audits.

Evaluating the Operating Effectiveness of Controls (Ref: Para.16–17)

A40. A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control.

A41. The concept of effectiveness of the operation of controls recognises that some deviations in the way controls are applied by the entity may occur. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions and human error. The detected rate of deviation, in particular in comparison with the expected rate, may indicate that the control cannot be relied on to reduce risk at the assertion level to that assessed by the auditor.

Substantive Procedures (Ref: Para. 6, 18)

A42. 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~~. 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 for significant classes of transactions, account balances or disclosures, designed and performed in accordance with paragraph 6, 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 material in accordance with ISA (NZ) 315 (Revised 2019).[50]
- 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.

A42a. Not all assertions within a material class of transactions, account balance or disclosure are required to be tested. Rather, in designing the substantive procedures to be performed, the auditor's consideration of the assertion(s) in which, if a misstatement were to occur, there is a reasonable possibility of the misstatement being material, may assist in identifying the appropriate nature, timing and extent of the procedures to be performed.

50 ISA (NZ) 315 (Revised 2019), paragraph 36

Nature and Extent of Substantive Procedures

A43. Depending on the circumstances, the auditor may determine that:

- Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.
- Only tests of details are appropriate.
- A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

A44. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. ISA (NZ) 520[51] establishes requirements and provides guidance on the application of analytical procedures during an audit.

A45. 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 statement 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.

A10. Because the assessment of the risk of material misstatement takes account of ~~internal~~ controls that the auditor plans to test, 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.

A47. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing. See ISA (NZ) 500.[52]

Considering Whether External Confirmation Procedures Are to Be Performed (Ref: Para. 19)

A48. External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no "side agreement" exists that may be relevant to an entity's revenue cutoff assertion. Other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include:

- Bank balances and other information relevant to banking relationships.
- Accounts receivable balances and terms.

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51 ISA (NZ) 520, *Analytical Procedures*

52 ISA (NZ) 500, *Audit Evidence*, paragraph 10

- Inventories held by third parties at bonded warehouses for processing or on consignment.
- Property title deeds held by lawyers or financiers for safe custody or as security.
- Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- Accounts payable balances and terms.

A49. Although external confirmations may provide relevant audit evidence relating to certain assertions, there are some assertions for which external confirmations provide less relevant audit evidence. For example, external confirmations provide less relevant audit evidence relating to the recoverability of accounts receivable balances, than they do of their existence.

A50. The auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for bank balances often include requests for information relevant to other financial statement assertions. Such considerations may influence the auditor's decision about whether to perform external confirmation procedures.

A51. Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

- The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- The ability or willingness of the intended confirming party to respond – for example, the confirming party:
  - May not accept responsibility for responding to a confirmation request;
  - May consider responding too costly or time consuming;
  - May have concerns about the potential legal liability resulting from responding;
  - May account for transactions in different currencies; or
  - May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

  In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.
- The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

Substantive Procedures Related to the Financial Statement Closing Process (Ref: Para. 20)

A52. The nature, and also the extent, of the auditor's substantive procedures related to the financial statement closing process depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement.

Substantive Procedures Responsive to Significant Risks (Ref: Para. 21)

A53. Paragraph 21 of this ISA (NZ) requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a risk that management is inflating sales by improperly recognising revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmation procedures not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmation procedures with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

Timing of Substantive Procedures (Ref: Para. 22–23)

A54. In most cases, audit evidence from a previous audit's substantive procedures provides little or no audit evidence for the current period. There are, however, exceptions, for example, a legal opinion obtained in a previous audit related to the structure of a securitisation to which no changes have occurred, may be relevant in the current period. In such cases, it may be appropriate to use audit evidence from a previous audit's substantive procedures if that evidence and the related subject matter have not fundamentally changed, and audit procedures have been performed during the current period to establish its continuing relevance.

Using audit evidence obtained during an interim period (Ref: Para. 22)

A55. In some circumstances, the auditor may determine that it is effective to perform substantive procedures at an interim date, and to compare and reconcile information concerning the balance at the period end with the comparable information at the interim date to:

(a) Identify amounts that appear unusual;

(b) Investigate any such amounts; and

(c) Perform substantive analytical procedures or tests of details to test the intervening period.

A56. 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.

A57. Factors such as the following may influence whether to perform substantive analytical procedures with respect to the period between the interim date and the period end:

- Whether the period-end balances of the particular classes of transactions or account balances are reasonably predictable with respect to amount, relative significance, and composition.
- Whether the entity's procedures for analysing and adjusting such classes of transactions or account balances at interim dates and for establishing proper accounting cutoffs are appropriate.
- Whether the information system ~~relevant to financial reporting~~ will provide information concerning the balances at the period end and the transactions in the remaining period that is sufficient to permit investigation of:
  (a) Significant unusual transactions or entries (including those at or near the period end);
  (b) Other causes of significant fluctuations, or expected fluctuations that did not occur; and
  (c) Changes in the composition of the classes of transactions or account balances.

Misstatements detected at an interim date (Ref: Para. 23)

A58. When the auditor concludes that the planned nature, timing or extent of substantive procedures covering the remaining period need to be modified as a result of unexpected misstatements detected at an interim date, such modification may include extending or repeating the procedures performed at the interim date at the period end.

Adequacy of Presentation of the Financial Statements (Ref: Para. 24)

A59. Evaluating the appropriate presentation, arrangement and content of the financial statements includes, for example, consideration of the terminology used as required by the applicable financial reporting framework, the level of detail provided, the aggregation and disaggregation of amounts and the bases of amounts set forth.

Evaluating the Sufficiency and Appropriateness of Audit Evidence (Ref: Para. 25–27)

A60. An audit of financial statements 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 reevaluate 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. ISA (NZ) 315 (Revised 2019) contains further guidance on revising the auditor's risk assessment.[53]

A61. The auditor cannot assume that an instance of fraud or error is an isolated occurrence. Therefore, the consideration of how the detection of a misstatement affects the assessed risks of material misstatement is important in determining whether the assessment remains appropriate.

A62. 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 statements.
- 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.

Documentation (Ref: Para. 28)

A63. The form and extent of audit documentation is a matter of professional judgement, and is influenced by the nature, size and complexity of the entity and its system of internal control, availability of information from the entity and the audit methodology and technology used in the audit.

ISA (NZ) 500, *Audit Evidence*

2. This ISA (NZ) is applicable to all the audit evidence obtained during the course of the audit. Other ISAs (NZ) deal with specific aspects of the audit (for example, ISA (NZ) 315 (Revised

[53] ISA (NZ) 315 (Revised 2019), paragraph 53~~31~~

2019)[54]), the audit evidence to be obtained in relation to a particular topic (for example, ISA (NZ) 570[55]), specific procedures to obtain audit evidence (for example, ISA (NZ) 520[56]), and the evaluation of whether sufficient appropriate audit evidence has been obtained (ISA (NZ) 200[57] and ISA (NZ) 330[58]).

Application and Other Explanatory Material

Sufficient Appropriate Audit Evidence (Ref: Para. 6)

~~A1~~A5. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has evaluated whether such information remains relevant and reliable as audit evidence for the current audit[1] ~~determined whether changes have occurred since the previous audit that may affect its relevance to the current audit~~) or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence.

...

Audit Procedures for Obtaining Audit Evidence

…

A14. As required by, and explained further in, ISA (NZ) 315 (Revised~~-~~2019) and ISA (NZ) 330, audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

(a) Risk assessment procedures; and

(b) Further audit procedures, which comprise:

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54 ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~*

55 ISA (NZ) 570 (Revised), *Going Concern*

56 ISA (NZ) 520, *Analytical Procedures*

57 ISA (NZ) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*

58 ISA (NZ) 330, *The Auditor's Responses to Assessed Risks*

3 ISA (NZ) 315 (Revised~~-~~2019), paragraph ~~9~~16

(i) Tests of controls, when required by the ISAs (NZ) or when the auditor has chosen to do so; and

(ii) Substantive procedures, including tests of details and substantive analytical procedures.

Observation

~~A17~~A21. Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of controls ~~activities~~. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed. See ISA (NZ) 501 for further guidance on observation of the counting of inventory.

…

A42. The nature and extent of the auditor's consideration takes into account the assessed risks of material misstatement at the assertion level to which the use of the external information is relevant, the degree to which the use of that information is relevant to the reasons for the assessed risks of material misstatement and the possibility that the information from the external information source may not be reliable (for example, whether it is from a credible source). Based on the auditor's consideration of the matters described in paragraph A39, the auditor may determine that further understanding of the entity and its environment, including its internal control, is needed, in accordance with ISA (NZ) 315 (Revised 2019), or that further audit procedures, in accordance with ISA (NZ) 330[20], and ISA (NZ) 540 (Revised)[21] when applicable, are appropriate in the circumstances, to respond to the assessed risks of material misstatement related to the use of information from an external information source.

…

ISA (NZ) 501, *Audit Evidence—Special Considerations for Selected Items*

Application and Other Explanatory Material

Inventory

Attendance at Physical Inventory Counting (Ref: Para. 4(a))

…

Evaluate Management's Instructions and Procedures (Ref: Para. 4(a)(i))

A4. Matters relevant in evaluating management's instructions and procedures for recording and controlling the physical inventory counting include whether they address, for example:

- The application of appropriate controls ~~activities~~, for example, collection of used physical inventory count records, accounting for unused physical inventory count records, and count and re-count procedures.

…

ISA (NZ) 530, *Audit Documentation*

Application and Other Explanatory Material

…

Sample Design, Size, and Selection of Items for Testing

Sample Design (Ref: Para. 6)

…

A7. In considering the characteristics of a population, for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of the ~~relevant~~ controls or on the examination of a small number of items from the population. This assessment is made in order to design an audit sample and to determine sample size….

…

Appendix 2 (Ref: Para. A11)

Example of Factors Influencing Sample Size for Test of Controls

The following are factors that the auditor may consider when determining the sample size for tests of controls. These factors, which need to be considered together, assume the auditor does not modify the nature or timing of tests of controls or otherwise modify the approach to substantive procedures in response to assessed risks.

Factor 1 An increase in the extent to which the auditor's risk assessment takes into account ~~relevant~~ plans to test the operating effectiveness of controls.

…

ISA (NZ) 550, Related Parties

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the auditor's responsibilities relating to related party relationships and transactions in an audit of financial statements. Specifically, it expands on how ISA (NZ) 315 (Revised 2019),[59] ISA (NZ) 330,[60] and ISA (NZ) 240[61] are to be applied in relation to risks of material misstatement associated with related party relationships and transactions.

…

[59] ISA (NZ) 315 (Revised 2019), "Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~."

[60] ISA (NZ) 330, "The Auditor's Responses to Assessed Risks."

[61] ISA (NZ) 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements."

11. As part of the risk assessment procedures and related activities that ISA (NZ) 315 (Revised 2019) and ISA (NZ) 240 require the auditor to perform during the audit,[62] the auditor shall perform the audit procedures and related activities set out in paragraphs 12-17 to obtain information relevant to identifying the risks of material misstatement associated with related party relationships and transactions. (Ref: Para. A8)

12. The engagement team discussion that ISA (NZ) 315 (Revised 2019~~-~~) and ISA (NZ) 240 require[63] shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions. (Ref: Para. A9-A10)

…

18. In meeting the ISA (NZ) 315 (Revised 2019) requirement to identify and assess the risks of material misstatement,[64] the auditor shall identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks. In making this determination, the auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks.

…

Application and Other Explanatory Material

…

Risk Assessment Procedures and Related Activities

...

A7. In some circumstances, a special-purpose entity[65] may be a related party of the entity because the entity may in substance control it, even if the entity owns little or none of the special-purpose entity's equity.

...

Understanding the Entity's Related Party Relationships and Transactions

Discussion among the Engagement Team (Ref: Para. 12)

[62] ISA (NZ) 315 (Revised 2019), paragraph ~~5~~13; and ISA (NZ) 240, paragraph 16.

[63] ISA (NZ) 315 (Revised 2019), paragraph ~~10~~17; and ISA (NZ) 240, paragraph 15.

[64] ISA (NZ) 315 (Revised 2019), paragraph ~~25~~28.

[65] ISA (NZ) 315 (Revised2019), paragraphs ~~A27-A28~~ A68-A70, provides guidance regarding the nature of a special-purpose entity.

A9. Matters that may be addressed in the discussion among the engagement team include:

- …
- The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirements), and the related risk of management override of ~~relevant~~ controls.

…

The Identity of the Entity's Related Parties (Ref: Para. 13(a))

…

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 inquiries specified by paragraph 13 still applies because management may be aware of parties that meet the related party definition set out in this ISA (NZ). In such a case, however, the auditor's inquiries 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 ISA (NZ) 315 (Revised 2019) 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 inquiries 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.

…

The Entity's Controls over Related Party Relationships and Transactions (Ref: Para. 14)

…

A17. In meeting the ISA (NZ) 315 (Revised 2019) requirement to obtain an understanding of the control environment,[66] the auditor may consider features of the control environment relevant to mitigating the risks of material misstatement associated with related party relationships and transactions, such as:

…

Considerations specific to smaller entities

[66] ISA (NZ) 315 (Revised 2019), paragraph ~~14~~21.

A20. Controls ~~activities~~ in smaller entities are likely to be less formal and smaller entities may have no documented processes for dealing with related party relationships and transactions. An owner-manager may mitigate some of the risks arising from related party transactions, or potentially increase those risks, through active involvement in all the main aspects of the transactions. For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through enquiry of management combined with other procedures, such as observation of management's oversight and review activities, and inspection of available relevant documentation.

…

Sharing Related Party Information with the Engagement Team (Ref: Para. 17)

A28. Relevant related party information that may be shared among the engagement team members includes, for example:

- 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 be determined to be significant risks ~~require special audit consideration~~, in particular transactions in which management or those charged with governance are financially involved.

…

Responses to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions (Ref: Para. 20)

…

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 ISA (NZ) 330 requirement to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls,[67] 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.

…

[67] ISA (NZ) 330, paragraph 8(b)

ISA (NZ) 540 (Revised), ***Auditing Accounting Estimates and Related Disclosures***

Introduction

Scope of this ISA (NZ)

1. This International Standard on Auditing (New Zealand) (ISA (NZ)) deals with the auditor's responsibilities relating to accounting estimates and related disclosures in an audit of financial statements. Specifically, it includes requirements and guidance that refer to, or expand on, how ISA (NZ) 315 (Revised 2019),[68] ISA (NZ) 330,[69] ISA(NZ) 450,[70] ISA (NZ) 500[71] and other relevant ISAs (NZ) are to be applied in relation to accounting estimates and related disclosures. It also includes requirements and guidance on the evaluation of misstatements of accounting estimates and related disclosures, and indicators of possible management bias.

Nature of Accounting Estimates

2. Accounting estimates vary widely in nature and are required to be made by management when the monetary amounts cannot be directly observed. The measurement of these monetary amounts is subject to estimation uncertainty, which reflects inherent limitations in knowledge or data. These limitations give rise to inherent subjectivity and variation in the measurement outcomes. The process of making accounting estimates involves selecting and applying a method using assumptions and data, which requires judgement by management and can give rise to complexity in measurement. The effects of complexity, subjectivity or other inherent risk factors on the measurement of these monetary amounts affects their susceptibility to misstatement. (Ref: Para. A1–A6, Appendix 1)

3. Although this ISA (NZ) applies to all accounting estimates, the degree to which an accounting estimate is subject to estimation uncertainty will vary substantially. The nature, timing and extent of the risk assessment and further audit procedures required by this ISA (NZ) will vary in relation to the estimation uncertainty and the assessment of the related risks of material misstatement. For certain accounting estimates, estimation uncertainty may be very low, based on their nature, and the complexity and subjectivity involved in making them may also be very low. For such accounting estimates, the risk assessment procedures and further audit procedures required by this ISA (NZ) would not be expected to be extensive. When estimation uncertainty, complexity or subjectivity are very high, such procedures would be expected to be much more extensive. This ISA (NZ) contains guidance on how the requirements of this ISA (NZ) can be scaled. (Ref: Para. A7)

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68 ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~*

69 ISA (NZ) 330, *The Auditor's Responses to Assessed Risks*

70 ISA (NZ) 450, *Evaluation of Misstatements Identified during the Audit*

71 ISA (NZ) 500, *Audit Evidence*

Key Concepts of This ISA (NZ)

4. ~~This~~ ISA (NZ) 315 (Revised 2019) requires a separate assessment of inherent risk for identified risks of material misstatement at the assertion level.[72] ~~purposes of assessing the risks of material misstatement at the assertion level for accounting estimates.~~ In the context of ISA (NZ) 540 (Revised), and ~~D~~depending on the nature of a particular accounting estimate, the susceptibility of an assertion to a misstatement that could be material may be subject to or affected by estimation uncertainty, complexity, subjectivity or other inherent risk factors, and the interrelationship among them. As explained in ISA (NZ) 200,[73] inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others. Accordingly, the assessment of inherent risk depends on the degree to which the inherent risk factors affect the likelihood or magnitude of misstatement, and varies on a scale that is referred to ~~in this ISA (NZ)~~ as the spectrum of inherent risk. (Ref: Para. A8–A9, A65–A66, Appendix 1)

5. This ISA (NZ) refers to relevant requirements in ISA (NZ) 315 (Revised 2019) and ISA (NZ) 330, and provides related guidance, to emphasise the importance of the auditor's decisions about controls relating to accounting estimates, including decisions about whether:

   - There are controls ~~relevant to the audit~~ required to be identified by ISA (NZ) 315 (Revised 2019), for which the auditor is required to evaluate their design and determine whether they have been implemented.
   - To test the operating effectiveness of ~~relevant~~ controls.

6. ~~This~~ ISA (NZ) 315 (Revised 2019) also requires a separate assessment of control risk when assessing the risks of material misstatement at the assertion level ~~for accounting estimates~~. In assessing control risk, the auditor takes into account whether the auditor's further audit procedures contemplate planned reliance on the operating effectiveness of controls. If the auditor does not ~~perform~~ plan to test~~s~~ the operating effectiveness of controls, or does not intend to rely on the operating effectiveness of controls, the auditor's assessment of ~~the risk of material misstatement at the assertion level~~ control risk ~~cannot be reduced for the effective operation of controls with respect to the particular assertion~~ is such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk.[74] (Ref: Para. A10)

7. This ISA (NZ) emphasises that the auditor's further audit procedures (including, where appropriate, tests of controls) need to be responsive to the reasons for the assessed risks of material misstatement at the assertion level, taking into account the effect of one or more inherent risk factors and the auditor's assessment of control risk.

8. The exercise of professional scepticism in relation to accounting estimates is affected by the auditor's consideration of inherent risk factors, and its importance increases when accounting estimates are subject to a greater degree of estimation uncertainty or are affected to a greater degree by complexity, subjectivity or other inherent risk factors. Similarly, the exercise of professional scepticism is important when there is greater susceptibility to misstatement due

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72 ISA (NZ) 315 (Revised 2019), paragraph 31

73 ISA (NZ) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)*, paragraph A40

~~74 ISA (NZ) 530, *Audit Sampling*, Appendix 3~~

to management bias or ~~fraud~~ other fraud risk factors insofar as they affect inherent risk. (Ref: Para. A11)

…

…

Objective

…

Definitions

…

Requirements

Risk Assessment Procedures and Related Activities

13. When obtaining an understanding of the entity and its environment, the applicable financial reporting framework and ~~including~~ the entity's system of internal control, as required by ISA (NZ) 315 (Revised 2019),[75] the auditor shall obtain an understanding of the following matters related to the entity's accounting estimates. The auditor's procedures to obtain the understanding shall be performed to the extent necessary to obtain audit evidence that provides an appropriate basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. (Ref: Para. A19–A22)

Obtaining an Understanding of t~~T~~he Entity and Its Environment and the Applicable Financial Reporting Framework

(a) The entity's transactions and other events or~~and~~ conditions that may give rise to the need for, or changes in, accounting estimates to be recognised or disclosed in the financial statements. (Ref: Para. A23)

(b) The requirements of the applicable financial reporting framework related to accounting estimates (including the recognition criteria, measurement bases, and the related presentation and disclosure requirements); and how they apply in the context of the nature and circumstances of the entity and its environment, including how ~~transactions and other events or conditions are subject to, or affected by,~~ the inherent risk factors affect susceptibility to misstatement of assertions. (Ref: Para. A24–A25)

(c) Regulatory factors relevant to the entity's accounting estimates, including, when applicable, regulatory frameworks related to prudential supervision. (Ref: Para. A26)

(d) The nature of the accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements, based on the auditor's understanding of the matters in 13(a)–(c) above. (Ref: Para. A27)

75 ISA (NZ) 315 (Revised 2019), paragraphs ~~3, 5–6, 9, 11–12, 15-17, and 20-21~~19–27

Obtaining an Understanding of t~~T~~he Entity's System of Internal Control

(e) The nature and extent of oversight and governance that the entity has in place over management's financial reporting process relevant to accounting estimates. (Ref: Para. A28–A30).

(f) How management identifies the need for, and applies, specialised skills or knowledge related to accounting estimates, including with respect to the use of a management's expert. (Ref: Para. A31)

(g) How the entity's risk assessment process identifies and addresses risks relating to accounting estimates. (Ref: Para. A32–A33)

(h) The entity's information system as it relates to accounting estimates, including:

  (i) How information relating to accounting estimates and related disclosures for significant classes of transactions, account balances or disclosures flows through the entity's information system ~~The classes of transactions, events and conditions, that are significant to the financial statements and that give rise to the need for, or changes in, accounting estimates and related disclosures~~; and (Ref: Para. A34–A35)

  (ii) For such accounting estimates and related disclosures, how management:

    a. Identifies the relevant methods, assumptions or sources of data, and the need for changes in them, that are appropriate in the context of the applicable financial reporting framework, including how management: (Ref: Para. A36–A37)

      i. Selects or designs, and applies, the methods used, including the use of models; (Ref: Para. A38–A39)

      ii. Selects the assumptions to be used, including consideration of alternatives, and identifies significant assumptions; (Ref: Para. A40–A43); and

      iii. Selects the data to be used; (Ref: Para. A44)

    b. Understands the degree of estimation uncertainty, including through considering the range of possible measurement outcomes; and (Ref: Para. A45)

    c. Addresses the estimation uncertainty, including selecting a point estimate and related disclosures for inclusion in the financial statements. (Ref: Para.A46–A49)

(i) Identified controls in the control activities component[76] ~~activities~~ ~~relevant to the audit~~ over management's process for making accounting estimates as described in paragraph 13(h)(ii). (Ref: Para. A50–A54)

(j) How management reviews the outcome(s) of previous accounting estimates and responds to the results of that review.

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[76] ISA (NZ) 315 (Revised 2019), paragraphs 26(a)(i)–(iv)

14. The auditor shall review the outcome of previous accounting estimates, or, where applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement in the current period. The auditor shall take into account the characteristics of the accounting estimates in determining the nature and extent of that review. The review is not intended to call into question judgements about previous period accounting estimates that were appropriate based on the information available at the time they were made. (Ref: Para. A55–A60)

…

Identifying and Assessing the Risks of Material Misstatement

16. In identifying and assessing the risks of material misstatement relating to an accounting estimate and related disclosures at the assertion level, including separately assessing inherent risk and control risk at the assertion level, as required by ISA (NZ) 315 (Revised 2019),[77] the auditor shall ~~separately assess inherent risk and control risk. The auditor shall~~ take the following into account in identifying the risks of material misstatement and in assessing inherent risk: (Ref: Para. A64–A71)

    (a) The degree to which the accounting estimate is subject to estimation uncertainty; and (Ref: Para. A72–A75)

    (b) The degree to which the following are affected by complexity, subjectivity, or other inherent risk factors: (Ref: Para. A76–A79)

        (i) The selection and application of the method, assumptions and data in making the accounting estimate; or

        (ii) The selection of management's point estimate and related disclosures for inclusion in the financial statements.

17. The auditor shall determine whether any of the risks of material misstatement identified and assessed in accordance with paragraph 16 are, in the auditor's judgement, a significant risk.[78] If the auditor has determined that a significant risk exists, the auditor shall identify controls that ~~obtain an understanding of the entity's controls, including control activities, relevant to~~ address that risk,~~.~~[79] and evaluate whether such controls have been designed effectively, and determine whether they have been implemented.[80] (Ref: Para. A80)

…

19. As required by ISA (NZ) 330,[81] the auditor shall design and perform tests to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls, if:

    (b) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively; or

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[77] ISA (NZ) 315 (Revised 2019), paragraph ~~25 and 26~~31 and 34

[78] ISA (NZ) 315 (Revised 2019), paragraph 32~~27~~

[79] ISA (NZ) 315 (Revised 2019), paragraph 26(a)(i)~~29~~

[80] ISA (NZ) 315 (Revised 2019), paragraph 26(a)

[81] ISA (NZ) 330, paragraph 8

(c) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

In relation to accounting estimates, the auditor's tests of such controls shall be responsive to the reasons for the assessment given to the risks of material misstatement. In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control.[82] (Ref: Para. A85–A89)

…

Other Considerations Relating to Audit Evidence

30. In obtaining audit evidence regarding the risks of material misstatement relating to accounting estimates, irrespective of the sources of information to be used as audit evidence, the auditor shall comply with the relevant requirements in ISA (NZ) 500.

When using the work of a management's expert, the requirements in paragraphs 21–29 of this ISA (NZ) may assist the auditor in evaluating the appropriateness of the expert's work as audit evidence for a relevant assertion in accordance with paragraph 8(c) of ISA (NZ) 500. In evaluating the work of the management's expert, the nature, timing and extent of the further audit procedures are affected by the auditor's evaluation of the expert's competence, capabilities and objectivity, the auditor's understanding of the nature of the work performed by the expert, and the auditor's familiarity with the expert's field of expertise. (Ref: Para. A126–A132)

…

Documentation

39. The auditor shall include in the audit documentation:[83] (Ref: Para. A149–A152)

(a) Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control related to the entity's accounting estimates;

(b) The linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the assertion level,[84] taking into account the reasons (whether related to inherent risk or control risk) given to the assessment of those risks;

(c) The auditor's response(s) when management has not taken appropriate steps to understand and address estimation uncertainty;

(d) Indicators of possible management bias related to accounting estimates, if any, and the auditor's evaluation of the implications for the audit, as required by paragraph 32; and

(e) Significant judgements relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated.

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82 ISA (NZ) 330, paragraph 9

83 ISA (NZ) 230, *Audit Documentation*, paragraphs 8–11, A6, A7 and A10

84 ISA (NZ) 330, paragraph 28(b)

Application and Other Explanatory Material

Nature of Accounting Estimates (Ref: Para. 2)

Examples of Accounting Estimates

…

Methods

A2. A method is a measurement technique used by management to make an accounting estimate in accordance with the required measurement basis. For example, one recognised method used to make accounting estimates relating to share-based payment transactions is to determine a theoretical option call price using the Black Scholes option pricing formula. A method is applied using a computational tool or process, sometimes referred to as a model, and involves applying assumptions and data and taking into account a set of relationships between them.

Assumptions and Data

A3. Assumptions involve judgements based on available information about matters such as the choice of an interest rate, a discount rate, or judgements about future conditions or events. An assumption may be selected by management from a range of appropriate alternatives. Assumptions that may be made or identified by a management's expert become management's assumptions when used by management in making an accounting estimate.

A4. For purposes of this ISA (NZ), data is information that can be obtained through direct observation or from a party external to the entity. Information obtained by applying analytical or interpretive techniques to data is referred to as derived data when such techniques have a well-established theoretical basis and therefore less need for management judgement. Otherwise, such information is an assumption.

A5. Examples of data include:

- Prices agreed in market transactions;
- Operating times or quantities of output from a production machine;
- Historical prices or other terms included in contracts, such as a contracted interest rate, a payment schedule, and term included in a loan agreement;
- Forward-looking information such as economic or earnings forecasts obtained from an external information source, or
- A future interest rate determined using interpolation techniques from forward interest rates (derived data).

A6. Data can come from a wide range of sources. For example, data can be:

- Generated within the organisation or externally;
- Obtained from a system that is either within or outside the general or subsidiary ledgers;
- Observable in contracts; or
- Observable in legislative or regulatory pronouncements.

Scalability (Ref: Para. 3)

A7. Examples of paragraphs that include guidance on how the requirements of this ISA (NZ) can be scaled include paragraphs A20–A22, A63, A67, and A84.

Key Concepts of This ISA (NZ)

Inherent Risk Factors (Ref: Para. 4)

A8. Inherent risk factors are characteristics of ~~conditions and~~ events or~~and~~ conditions that ~~may~~ affect ~~the~~ susceptibility ~~of an assertion~~ to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosures, before consideration of controls.[85] Appendix 1 further explains the nature of these inherent risk factors, and their inter-relationships, in the context of making accounting estimates and their presentation in the financial statements.

A9. ~~In addition to the inherent risk factors of estimation uncertainty, complexity or subjectivity, other inherent risk factors that the auditor may consider in identifying and~~ When assessing the risks of material misstatement at the assertion level[86], in addition to estimation uncertainty, complexity, and subjectivity, the auditor also takes into account the degree ~~may include the extent~~ to which inherent risk factors included in ISA (NZ) 315 (Revised 2019)~~,~~ (other than estimation uncertainty, complexity, and subjectivity)~~,~~ affect susceptibility ~~to misstatement~~ of assertions to misstatement about the accounting estimate. Such additional inherent risk factors include ~~is subject to, or affected by~~:

- Change in the nature or circumstances of the relevant financial statement items, or requirements of the applicable financial reporting framework which may give rise to the need for changes in the method, assumptions or data used to make the accounting estimate.
- Susceptibility to misstatement due to management bias, or other fraud risk factors insofar as they affect inherent risk, in making the accounting estimate.
- Uncertainty, other than estimation uncertainty.

Control Risk (Ref: Para. 6)

A10. ~~An important consideration for the auditor i~~In assessing control risk at the assertion level in accordance with ISA (NZ) 315 (Revised 2019), the auditor takes into account ~~is the effectiveness of the design of the controls that~~ whether the auditor ~~intends~~ plans to ~~rely~~ test ~~on~~ the operating effectiveness of controls. ~~and the extent to which the controls address the assessed inherent risks at the assertion level.~~ When the auditor is considering whether to test the operating effectiveness of controls, ~~T~~the auditor's evaluation that controls are effectively designed and have been implemented supports an expectation, by the auditor, about the operating effectiveness of the controls in ~~determining whether~~ establishing the plan to test them.

[85] ISA (NZ) 315 (Revised 2019), paragraph 12(f)

[86] ISA (NZ) 315 (Revised 2019), paragraph 31

Professional Scepticism (Ref: Para. 8)

….

Concept of "Reasonable" (Ref: Para. 9, 35)

…

Risk Assessment Procedures and Related Activities

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control (Ref: Para. 13)

A19. Paragraphs 19~~11~~-27~~24~~ of ISA (NZ) 315 (Revised 2019) require the auditor to obtain an understanding of certain matters about the entity and its environment, the applicable financial reporting framework and ~~including~~ the entity's system of internal control. The requirements in paragraph 13 of this ISA (NZ) relate more specifically to accounting estimates and build on the broader requirements in ISA (NZ) 315 (Revised 2019).

Scalability

A20. The nature, timing, and extent of the auditor's procedures to obtain the understanding of the entity and its environment, ~~including~~ the applicable financial reporting framework, and the entity's system of internal control, related to the entity's accounting estimates, may depend, to a greater or lesser degree, on the extent to which the individual matter(s) apply in the circumstances. For example, the entity may have few transactions or other events ~~and~~ or conditions that give rise to the need for accounting estimates, the applicable financial reporting requirements may be simple to apply, and there may be no relevant regulatory factors. Further, the accounting estimates may not require significant judgements, and the process for making the accounting estimates may be less complex. In these circumstances, the accounting estimates may be subject to, or affected by, estimation uncertainty, complexity, subjectivity, or other inherent risk factors to a lesser degree, and there may be fewer identified controls in the control activities component ~~relevant to the audit~~. If so, the auditor's risk identification and assessment procedures are likely to be less extensive and may be obtained primarily through inquiries of management with appropriate responsibilities for the financial statements, such as ~~and~~ simple walk-throughs of management's process for making the accounting estimate (including when evaluating whether identified controls in that process are designed effectively and when determining whether the control has been implemented).

A21. By contrast, the accounting estimates may require significant judgements by management, and the process for making the accounting estimates may be complex and involve the use of complex models. In addition, the entity may have a more sophisticated information system, and more extensive controls over accounting estimates. In these circumstances, the accounting estimates may be subject to or affected by estimation uncertainty, subjectivity, complexity or other inherent risk factors to a greater degree. If so, the nature or timing of the auditor's risk assessment procedures are likely to be different, or be more extensive, than in the circumstances in paragraph A20.

A22. The following considerations may be relevant for entities with only simple businesses, which may include many smaller entities:

- Processes relevant to accounting estimates may be uncomplicated because the business activities are simple or the required estimates may have a lesser degree of estimation uncertainty.
- Accounting estimates may be generated outside of the general and subsidiary ledgers, controls over their development may be limited, and an owner-manager may have significant influence over their determination. The owner-manager's role in making the accounting estimates may need to be taken into account by the auditor both when identifying the risks of material misstatement and when considering the risk of management bias.

The Entity and Its Environment

The entity's transactions and other events ~~and~~ or conditions (Ref: Para. 13(a))

A23. Changes in circumstances that may give rise to the need for, or changes in, accounting estimates may include, for example, whether:

- The entity has engaged in new types of transactions;
- Terms of transactions have changed; or
- New events or conditions have occurred.

The requirements of the applicable financial reporting framework (Ref: Para. 13(b))

A24. Obtaining an understanding of the requirements of the applicable financial reporting framework provides the auditor with a basis for discussion with management and, where applicable, those charged with governance about how management has applied the~~ose~~ requirements of the applicable financial reporting framework relevant to the accounting estimates, and about the auditor's determination of whether they have been applied appropriately. This understanding also may assist the auditor in communicating with those charged with governance when the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework, not to be the most appropriate in the circumstances of the entity.[87]

A25. In obtaining this understanding, the auditor may seek to understand whether:

- The applicable financial reporting framework:
  - o Prescribes certain criteria for the recognition, or methods for the measurement of accounting estimates;
  - o Specifies certain criteria that permit or require measurement at a fair value, for example, by referring to management's intentions to carry out certain courses of action with respect to an asset or liability; or
  - o Specifies required or suggested disclosures, including disclosures concerning judgements, assumptions, or other sources of estimation uncertainty relating to accounting estimates; and

87 ISA (NZ) 260 (Revised), paragraph 16(a)

- Changes in the applicable financial reporting framework require changes to the entity's accounting policies relating to accounting estimates.

Regulatory factors (Ref: Para. 13(c))

…

The nature of the accounting estimates and related disclosures that the auditor expects to be included in the financial statements (Ref: Para. 13(d))

…

The Entity's System of Internal Control ~~Relevant to the Audit~~

The nature and extent of oversight and governance (Ref: Para. 13(e))

A28. In applying ISA (NZ) 315 (Revised 2019),[88] the auditor's understanding of the nature and extent of oversight and governance that the entity has in place over management's process for making accounting estimates may be important to the auditor's required evaluation of ~~as it relates to~~ whether:

- Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behaviour; ~~and~~
- The ~~strengths in the entity's~~ control environment ~~elements~~ ~~collectively~~ provides an appropriate foundation for the other components of the system of internal control considering the nature and size of the entity; and ~~whether~~
- ~~those other components are undermined by c~~Control deficiencies identified in the control environment undermine the other components of the system of internal control.

…

A30. Obtaining an understanding of the oversight by those charged with governance may be important when there are accounting estimates that:

- Require significant judgement by management to address subjectivity;
- Have high estimation uncertainty;
- Are complex to make, for example, because of the extensive use of information technology, large volumes of data or the use of multiple data sources or assumptions with complex-interrelationships;
- Had, or ought to have had, a change in the method, assumptions or data compared to previous periods; or
- Involve significant assumptions.

Management's application of specialised skills or knowledge, including the use of management's experts (Ref: Para. 13(f))

…

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88 ISA (NZ) 315 (Revised 2019), paragraph 21(a)~~14~~

The entity's risk assessment process (Ref: Para. 13(g))

A32. Understanding how the entity's risk assessment process identifies and addresses risks relating to accounting estimates may assist the auditor in considering changes in:

- The requirements of the applicable financial reporting framework related to the accounting estimates;
- The availability or nature of data sources that are relevant to making the accounting estimates or that may affect the reliability of the data used;
- The entity's information systems or IT environment; and
- Key personnel.

A33. Matters that the auditor may consider in obtaining an understanding of how management identified and addresses the susceptibility to misstatement due to management bias or fraud in making accounting estimates, include whether, and if so how, management:

- Pays particular attention to selecting or applying the methods, assumptions and data used in making accounting estimates.
- Monitors key performance indicators that may indicate unexpected or inconsistent performance compared with historical or budgeted performance or with other known factors.
- Identifies financial or other incentives that may be a motivation for bias.
- Monitors the need for changes in the methods, significant assumptions or the data used in making accounting estimates.
- Establishes appropriate oversight and review of models used in making accounting estimates.
- Requires documentation of the rationale for, or an independent review of, significant judgements made in making accounting estimates.

The entity's information system relating to accounting estimates (Ref: Para. 13(h)(i))

A34. The significant classes of transactions, events and conditions within the scope of paragraph 13(h) are the same as the significant classes of transactions, events and conditions relating to accounting estimates and related disclosures that are subject to paragraph~~s~~ 25(a)~~18~~(a) ~~and (d)~~ of ISA (NZ) 315 (Revised 2019). In obtaining the understanding of the entity's information system as it relates to accounting estimates, the auditor may consider:

- Whether the accounting estimates arise from the recording of routine and recurring transactions or whether they arise from non-recurring or unusual transactions.
- How the information system addresses the completeness of accounting estimates and related disclosures, in particular for accounting estimates related to liabilities.

A35. During the audit, the auditor may identify classes of transactions, events ~~and~~ or conditions that give rise to the need for accounting estimates and related disclosures that management failed to identify. ISA (NZ) 315 (Revised 2019) deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including ~~determining whether there is a significant deficiency in internal control with regard to~~

considering the implications for the auditor's evaluation of the entity's risk assessment process.[89]

Management's Identification of the Relevant Methods, Assumptions and Sources of Data (Ref: Para. 13(h)(ii)(a)

…

Methods (Ref: Para. 13(h)(ii)(a)(i))

…

Models

A39. Management may design and implement specific controls around models used for making accounting estimates, whether management's own model or an external model. When the model itself has an increased level of complexity or subjectivity, such as an expected credit loss model or a fair value model using level 3 inputs, controls that address such complexity or subjectivity may be. When complexity in relation to models is present, controls over data integrity are also more likely to be identified controls in accordance with ISA (NZ) 315 (Revised 2019)~~relevant to the audit~~. Factors that may be appropriate for the auditor to consider in obtaining an understanding of the model and ~~of~~ related identified controls ~~activities~~ ~~relevant to the audit~~ include the following:

- How management determines the relevance and accuracy of the model;
- The validation or back testing of the model, including whether the model is validated prior to use and revalidated at regular intervals to determine whether it remains suitable for its intended use. The entity's validation of the model may include evaluation of:
  - The model's theoretical soundness;
  - The model's mathematical integrity; and
  - The accuracy and completeness of the data and the appropriateness of data and assumptions used in the model.
- How the model is appropriately changed or adjusted on a timely basis for changes in market or other conditions and whether there are appropriate change control policies over the model;
- Whether adjustments, also referred to as overlays in certain industries, are made to the output of the model and whether such adjustments are appropriate in the circumstances in accordance with the requirements of the applicable financial reporting framework. When the adjustments are not appropriate, such adjustments may be indicators of possible management bias; and
- Whether the model is adequately documented, including its intended applications, limitations, key parameters, required data and assumptions, the results of any validation performed on it and the nature of, and basis for, any adjustments made to its output.

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129 ISA (NZ) 315 (Revised 2019), paragraph 22(b)~~43~~

Assumptions (Ref: Para. 13(h)(ii)(a)(ii))

…

Data (Ref: Para. 13(h)(ii)(a)(iii))

A44. Matters that the auditor may consider in obtaining an understanding of how management selects the data on which the accounting estimates are based include:

- The nature and source of the data, including information obtained from an external information source.
- How management evaluates whether the data is appropriate.
- The accuracy and completeness of the data.
- The consistency of the data used with data used in previous periods.
- The complexity of IT applications or other aspects of the entity’s IT environment ~~the information technology systems~~ used to obtain and process the data, including when this involves handling large volumes of data.
- How the data is obtained, transmitted and processed and how its integrity is maintained.

How management understands and addresses estimation uncertainty (Ref: Para. 13(h)(ii)(b)–13(h)(ii)(c))

…

Identified Controls ~~Activities~~ ~~Relevant to the Audit~~ Over Management’s Process for Making Accounting Estimates (Ref: Para 13(i))

A50. The auditor’s judgement in identifying controls ~~relevant to the audit~~in the control~~s~~ activities component, and therefore the need to evaluate the design of those controls and determine whether they have been implemented, relates to management’s process described in paragraph 13(h)(ii). The auditor may not identify ~~relevant~~ controls ~~activities~~ in relation to all ~~the elements~~ aspects of paragraph 13(h)(ii).~~, depending on the complexity associated with the accounting estimate.~~

A51. As part of ~~obtaining an understanding of~~ identifying the controls ~~activities relevant to the audit~~, and evaluating their design and determining whether they have been implemented, the auditor may consider:

- How management determines the appropriateness of the data used to develop the accounting estimates, including when management uses an external information source or data from outside the general and subsidiary ledgers.
- The review and approval of accounting estimates, including the assumptions or data used in their development, by appropriate levels of management and, where appropriate, those charged with governance.
- The segregation of duties between those responsible for making the accounting estimates and those committing the entity to the related transactions, including whether the assignment of responsibilities appropriately takes account of the nature of the entity and its products or services. For example, in the case of a large financial institution, relevant segregation of duties may consist of an independent function responsible for

estimation and validation of fair value pricing of the entity's financial products staffed by individuals whose remuneration is not tied to such products.

- The effectiveness of the design of the controls. ~~activities.~~ Generally, it may be more difficult for management to design controls that address subjectivity and estimation uncertainty in a manner that effectively prevents, or detects and corrects, material misstatements, than it is to design controls that address complexity. Controls that address subjectivity and estimation uncertainty may need to include more manual elements, which may be less reliable than automated controls as they can be more easily bypassed, ignored or overridden by management. The design effectiveness of controls addressing complexity may vary depending on the reason for, and the nature of, the complexity. For example, it may be easier to design more effective controls related to a method that is routinely used or over the integrity of data.

A52. When management makes extensive use of information technology in making an accounting estimate, identified controls ~~relevant to the audit~~ in the control activities component are likely to include general IT controls and ~~application~~ information processing controls. Such controls may address risks related to:

- Whether the IT applications or other aspects of the IT environment ~~information technology system~~ has the capability and is appropriately configured to process large volumes of data;
- Complex calculations in applying a method. When diverse IT applications ~~systems~~ are required to process complex transactions, regular reconciliations between the IT applications ~~systems~~ are made, in particular when the IT applications ~~systems~~ do not have automated interfaces or may be subject to manual intervention;
- Whether the design and calibration of models is periodically evaluated;
- The complete and accurate extraction of data regarding accounting estimates from the entity's records or from external information sources;
- Data, including the complete and accurate flow of data through the entity's information system, the appropriateness of any modification to the data used in making accounting estimates, the maintenance of the integrity and security of the data. When using external information sources, risks related to processing or recording the data;
- Whether management has controls around access, change and maintenance of individual models to maintain a strong audit trail of the accredited versions of models and to prevent unauthorised access or amendments to those models; and
- Whether there are appropriate controls over the transfer of information relating to accounting estimates into the general ledger, including appropriate controls over journal entries.

A53. In some industries, such as banking or insurance, the term governance may be used to describe activities within the control environment, the entity's process to monitor the system of internal control ~~monitoring of controls~~, and other components of the system of internal control, as described in ISA (NZ) 315 (Revised 2019).[90]

[90] ISA (NZ) 315 (Revised 2019), Appendix 3 ~~paragraph A77~~

A54. For entities with an internal audit function, its work may be particularly helpful to the auditor in obtaining an understanding of:

- The nature and extent of management's use of accounting estimates;
- The design and implementation of controls ~~activities~~ that address the risks related to the data, assumptions and models used to make the accounting estimates;
- The aspects of the entity's information system that generate the data on which the accounting estimates are based; and
- How new risks relating to accounting estimates are identified, assessed and managed.

Reviewing the Outcome or Re-Estimation of Previous Accounting Estimates (Ref: Para. 14)

…

A58. Based on the auditor's previous assessment of the risks of material misstatement, for example, if inherent risk is assessed as higher for one or more risks of material misstatement, the auditor may judge that a more detailed retrospective review is required. As part of the detailed retrospective review, the auditor may pay particular attention, when practicable, to the effect of data and significant assumptions used in making the previous accounting estimates. On the other hand, for example, for accounting estimates that arise from the recording of routine and recurring transactions, the auditor may judge that the application of analytical procedures as risk assessment procedures is sufficient for purposes of the review.

A59. The measurement objective for fair value accounting estimates and other accounting estimates, based on current conditions at the measurement date, deals with perceptions about value at a point in time, which may change significantly and rapidly as the environment in which the entity operates changes. The auditor may therefore focus the review on obtaining information that may be relevant to identifying and assessing risks of material misstatement. For example, in some cases, obtaining an understanding of changes in marketplace participant assumptions that affected the outcome of a previous period's fair value accounting estimates may be unlikely to provide relevant audit evidence. In this case, audit evidence may be obtained by understanding the outcomes of assumptions (such as a cash flow projections) and understanding the effectiveness of management's prior estimation process that supports the identification and assessment of the risks of material misstatement in the current period.

A60. A difference between the outcome of an accounting estimate and the amount recognised in the previous period's financial statements does not necessarily represent a misstatement of the previous period's financial statements. However, such a difference may represent a misstatement if, for example, the difference arises from information that was available to management when the previous period's financial statements were finalised, or that could reasonably be expected to have been obtained and taken into account in the context of the applicable financial reporting framework.[91] Such a difference may call into question management's process for taking information into account in making the accounting estimate. As a result, the auditor may reassess any plan to test related controls and the related assessment of control risk ~~and~~ or may determine that more persuasive audit evidence needs to be obtained about the matter. Many financial reporting frameworks contain guidance on

[91] ISA (NZ) 560, Subsequent Events, paragraph 14

distinguishing between changes in accounting estimates that constitute misstatements and changes that do not, and the accounting treatment required to be followed in each case.

Specialised Skills or Knowledge (Ref: Para. 15)

…

Identifying and Assessing the Risks of Material Misstatement (Ref: Para. 4, 16)

A64. Identifying and assessing risks of material misstatement at the assertion level relating to accounting estimates is important for all accounting estimates, including not only those that are recognised in the financial statements, but also those that are included in the notes to the financial statements.

A65. Paragraph A42 of ISA (NZ) 200 states that the ISAs (NZ) ~~do not ordinarily refer to inherent risk and control risk separately~~ typically refer to the "risks of material misstatement" rather than to inherent risk and control risk separately. ~~However, this~~ ISA (NZ) 315 (Revised 2019) requires a separate assessment of inherent risk and control risk to provide a basis for designing and performing further audit procedures to respond to the risks of material misstatement at the assertion level,[92] including significant risks,~~ at the assertion level for accounting estimates~~ in accordance with ISA (NZ) 330.~~[93]~~

A66. In identifying the risks of material misstatement and in assessing inherent risk for accounting estimates in accordance with ISA (NZ) 315 (Revised 2019),[94] the auditor is required to take into account ~~the degree to which the accounting estimate is subject to, or affected by,~~ the inherent risk factors that affect susceptibility to misstatement of assertions, and how they do so ~~estimation uncertainty, complexity, subjectivity, or other inherent risk factors~~. The auditor's consideration of the inherent risk factors may also provide information to be used in ~~determining~~:

- Assessing the likelihood and magnitude of misstatement (i.e., ~~W~~where inherent risk is assessed on the spectrum of inherent risk); and
- Determining ~~T~~the reasons for the assessment given to the risks of material misstatement at the assertion level, and that the auditor's further audit procedures in accordance with paragraph 18 are responsive to those reasons.

The interrelationships between the inherent risk factors are further explained in Appendix 1.

A67. The reasons for the auditor's assessment of inherent risk at the assertion level may result from one or more of the inherent risk factors of estimation uncertainty, complexity, subjectivity or other inherent risk factors. For example:

(a) Accounting estimates of expected credit losses are likely to be complex because the expected credit losses cannot be directly observed and may require the use of a complex model. The model may use a complex set of historical data and assumptions about future developments in a variety of entity specific scenarios that may be difficult to predict. Accounting estimates for expected credit losses are also likely to be subject to

[92] ISA (NZ) 315 (Revised 2019), paragraphs 31 and 34

~~[93] ISA (NZ) 330, paragraph 7(b)~~

[94] ISA (NZ) 315 (Revised 2019), paragraph 31(a)

high estimation uncertainty and significant subjectivity in making judgements about future events or conditions. Similar considerations apply to insurance contract liabilities.

(b) An accounting estimate for an obsolescence provision for an entity with a wide range of different inventory types may require complex systems and processes, but may involve little subjectivity and the degree of estimation uncertainty may be low, depending on the nature of the inventory.

(c) Other accounting estimates may not be complex to make but may have high estimation uncertainty and require significant judgement, for example, an accounting estimate that requires a single critical judgement about a liability, the amount of which is contingent on the outcome of the litigation.

A68. The relevance and significance of inherent risk factors may vary from one estimate to another. Accordingly, the inherent risk factors may, either individually or in combination, affect simple accounting estimates to a lesser degree and the auditor may identify fewer risks or assess inherent risk ~~at~~ close to the lower end of the spectrum of inherent risk.

A69. Conversely, the inherent risk factors may, either individually or in combination, affect complex accounting estimates to a greater degree, and may lead the auditor to assess inherent risk at the higher end of the spectrum of inherent risk. For these accounting estimates, the auditor's consideration of the effects of the inherent risk factors is likely to directly affect the number and nature of identified risks of material misstatement, the assessment of such risks, and ultimately the persuasiveness of the audit evidence needed in responding to the assessed risks. Also, for these accounting estimates the auditor's application of professional scepticism may be particularly important.

A70. Events occurring after the date of the financial statements may provide additional information relevant to the auditor's assessment of the risks of material misstatement at the assertion level. For example, the outcome of an accounting estimate may become known during the audit. In such cases, the auditor may assess or revise the assessment of the risks of material misstatement at the assertion level,[95] regardless of how the inherent risk factors affect susceptibility of assertions to misstatement relating to ~~degree to which~~ the accounting estimate. ~~was subject to, or affected by, estimation uncertainty, complexity, subjectivity or other inherent risk factors.~~ Events occurring after the date of the financial statements also may influence the auditor's selection of the approach to testing the accounting estimate in accordance with paragraph 18. For example, for a simple bonus accrual that is based on a straightforward percentage of compensation for selected employees, the auditor may conclude that there is relatively little complexity or subjectivity in making the accounting estimate, and therefore may assess inherent risk at the assertion level ~~at~~ close to the lower end of the spectrum of inherent risk. The payment of the bonuses subsequent to period end may provide sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the assertion level.

A71. The auditor's assessment of control risk may be done in different ways depending on preferred audit techniques or methodologies. The control risk assessment may be expressed using qualitative categories (for example, control risk assessed as maximum, moderate,

95 ISA (NZ) 315 (Revised 2019), paragraph 37~~31~~

minimum) or in terms of the auditor's expectation of how effective the control(s) is in addressing the identified risk, that is, the planned reliance on the effective operation of controls. For example, if control risk is assessed as maximum, the auditor contemplates no reliance on the effective operation of controls. If control risk is assessed at less than maximum, the auditor contemplates reliance on the effective operation of controls.

Estimation Uncertainty (Ref: Para. 16(a))

A72. In taking into account the degree to which the accounting estimate is subject to estimation uncertainty, the auditor may consider:

- Whether the applicable financial reporting framework requires:
  - The use of a method to make the accounting estimate that inherently has a high level of estimation uncertainty. For example, the financial reporting framework may require the use of unobservable inputs.
  - The use of assumptions that inherently have a high level of estimation uncertainty, such as assumptions with a long forecast period, assumptions that are based on data that is unobservable and are therefore difficult for management to develop, or the use of various assumptions that are interrelated.
  - Disclosures about estimation uncertainty.
- The business environment. An entity may be active in a market that experiences turmoil or possible disruption (for example, from major currency movements or inactive markets) and the accounting estimate may therefore be dependent on data that is not readily observable.
- Whether it is possible (or practicable, insofar as permitted by the applicable financial reporting framework) for management:
  - To make a precise and reliable prediction about the future realisation of a past transaction (for example, the amount that will be paid under a contingent contractual term), or about the incidence and impact of future events or conditions (for example, the amount of a future credit loss or the amount at which an insurance claim will be settled and the timing of its settlement); or
  - To obtain precise and complete information about a present condition (for example, information about valuation attributes that would reflect the perspective of market participants at the date of the financial statements, to develop a fair value estimate).

A73. The size of the amount recognised or disclosed in the financial statements for an accounting estimate is not, in itself, an indicator of its susceptibility to misstatement because, for example, the accounting estimate may be understated.

A74. In some circumstances, the estimation uncertainty may be so high that a reasonable accounting estimate cannot be made. The applicable financial reporting framework may preclude recognition of an item in the financial statements, or its measurement at fair value. In such cases, there may be risks of material misstatement that relate not only to whether an accounting estimate should be recognised, or whether it should be measured at fair value, but also to the reasonableness of the disclosures. With respect to such accounting estimates, the applicable financial reporting framework may require disclosure of the accounting estimates and the estimation uncertainty associated with them (see paragraphs A112–A113, A143–A144).

A75. In some cases, the estimation uncertainty relating to an accounting estimate may cast significant doubt about the entity's ability to continue as a going concern. ISA (NZ) 570 (Revised)[96] establishes requirements and provides guidance in such circumstances.

Complexity or Subjectivity (Ref: Para. 16(b))

The Degree to Which Complexity Affects the Selection and Application of the Method

A76. In taking into account the degree to which the selection and application of the method used in making the accounting estimate are affected by complexity, the auditor may consider:

- The need for specialised skills or knowledge by management which may indicate that the method used to make an accounting estimate is inherently complex and therefore the accounting estimate may have a greater susceptibility to material misstatement. There may be a greater susceptibility to material misstatement when management has developed a model internally and has relatively little experience in doing so, or uses a model that applies a method that is not established or commonly used in a particular industry or environment.
- The nature of the measurement basis required by the applicable financial reporting framework, which may result in the need for a complex method that requires multiple sources of historical and forward-looking data or assumptions, with multiple interrelationships between them. For example, an expected credit loss provision may require judgements about future credit repayments and other cash flows, based on consideration of historical experience data and the application of forward looking assumptions. Similarly, the valuation of an insurance contract liability may require judgements about future insurance contract payments to be projected based on historical experience and current and assumed future trends.

The Degree to Which Complexity Affects the Selection and Application of the Data

A77. In taking into account the degree to which the selection and application of the data used in making the accounting estimate are affected by complexity, the auditor may consider:

- The complexity of the process to derive the data, taking into account the relevance and reliability of the data source. Data from certain sources may be more reliable than from others. Also, for confidentiality or proprietary reasons, some external information sources will not (or not fully) disclose information that may be relevant in considering the reliability of the data they provide, such as the sources of the underlying data they used or how it was accumulated and processed.
- The inherent complexity in maintaining the integrity of the data. When there is a high volume of data and multiple sources of data, there may be inherent complexity in maintaining the integrity of data that is used to make an accounting estimate.
- The need to interpret complex contractual terms. For example, the determination of cash inflows or outflows arising from a commercial supplier or customer rebates may

96 ISA (NZ) 570, (Revised), *Going Concern*

depend on very complex contractual terms that require specific experience or competence to understand or interpret.

The Degree to Which Subjectivity Affects the Selection and Application of the Method, Assumptions or Data

A78. In taking into account the degree to which the selection and application of method, assumptions or data are affected by subjectivity, the auditor may consider:

- The degree to which the applicable financial reporting framework does not specify the valuation approaches, concepts, techniques and factors to use in the estimation method.
- The uncertainty regarding the amount or timing, including the length of the forecast period. The amount and timing is a source of inherent estimation uncertainty, and gives rise to the need for management judgement in selecting a point estimate, which in turn creates an opportunity for management bias. For example, an accounting estimate that incorporates forward looking assumptions may have a high degree of subjectivity which may be susceptible to management bias.

Other Inherent Risk Factors (Ref: Para. 16(b))

A79. The degree of subjectivity associated with an accounting estimate influences the susceptibility of the accounting estimate to misstatement due to management bias or ~~fraud~~ other fraud risk factors insofar as they affect inherent risk. For example, when an accounting estimate is subject to a high degree of subjectivity, the accounting estimate is likely to be more susceptible to misstatement due to management bias or fraud and this may result in a wide range of possible measurement outcomes. Management may select a point estimate from that range that is inappropriate in the circumstances, or that is inappropriately influenced by unintentional or intentional management bias, and that is therefore misstated. For continuing audits, indicators of possible management bias identified during the audit of preceding periods may influence the planning and risk assessment procedures in the current period.

Significant Risks (Ref: Para. 17)

A80. The auditor's assessment of inherent risk, which takes into account the degree to which an accounting estimate is subject to, or affected by estimation uncertainty, complexity, subjectivity or other inherent risk factors, assists the auditor in determining whether any of the risks of material misstatement identified and assessed are a significant risk.

…

When the Auditor Intends to Rely on the Operating Effectiveness of ~~Relevant~~ Controls (Ref: Para: 19)

A85. Testing the operating effectiveness of ~~relevant~~ controls may be appropriate when inherent risk is assessed as higher on the spectrum of inherent risk, including for significant risks. This may be the case when the accounting estimate is subject to or affected by a high degree of complexity. When the accounting estimate is affected by a high degree of subjectivity, and therefore requires significant judgement by management, inherent limitations in the effectiveness of the design of controls may lead the auditor to focus more on substantive procedures than on testing the operating effectiveness of controls.

…

Overall Evaluation Based on Audit Procedures Performed (Ref: Para. 33)

…

Determining Whether the Accounting Estimates are Reasonable or Misstated (Ref: Para. 9, 35)

…

ISA (NZ) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Requirements

Understanding the Group, Its Components and Their Environments

17. The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the system of internal control.[97] The group engagement team shall:

    (a) …

18. The group engagement team shall obtain an understanding that is sufficient to:

    (a) Confirm or revise its initial identification of components that are likely to be significant; and

    (b) Assess the risks of material misstatement of the group financial statements, whether due to fraud or error.[98] (Ref: Para. A30-A31)

Application and Other Explanatory Material

…

Definitions

…

Significant Component (Ref: Para. 9(m))

…

A6. The group engagement team may also identify a component as likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances. ~~(that is, risks that require special audit consideration[99]).~~ For example, a component could be responsible for foreign exchange trading and thus expose the group to

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[97] ISA (NZ) 315 (Revised 2019) "Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~."

[98] ISA (NZ) 315 (Revised 2019).

~~[99] ISA (NZ) 315 (Revised), paragraphs 27–29~~

a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group.

…

Understanding the Group, Its Components, and Their Environments

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

A23. ISA (NZ) 315 (Revised 2019) contains guidance on matters the auditor may consider when obtaining an understanding of the industry, regulatory, and other external factors that affect the entity, including the applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and measurement and review of the entity's financial performance.[100] Appendix 2 of this ISA (NZ) contains guidance on matters specific to a group including the consolidation process.

Discussion among Group Engagement Team Members and Component Auditors Regarding the Risks of Material Misstatement of the Group Financial Statements, Including Risks of Fraud (Ref: Para. 17)

A28. The key members of the engagement team are required to discuss the susceptibility of an entity to material misstatement of the financial statements due to fraud or error, specifically emphasising the risks due to fraud. In a group audit, these discussions may also include the component auditors.[101]

Appendix 2

Examples of Matters about Which the Group Engagement Team Obtains an Understanding

…

Group-Wide Controls

1. Group-wide controls may include a combination of the following:

   - Regular meetings between group and component management to discuss business developments and to review performance.
   - …
   - Controls ~~activities~~ within an IT system that is common for all or some components.
   - Controls within the group's process to monitor ~~Monitoring~~ the system of internal controls~~s~~, including activities of the internal audit function and self-assessment programs.
   - …

[100] ISA (NZ) 315 (Revised 2019), paragraphs A62~~25~~–A64~~49~~ and Appendix 1

[101] ISA (NZ) 240, paragraph 15; ISA (NZ) 315 (Revised 2019), paragraph ~~10~~17.

Appendix 5

Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction

Matters that are relevant to the planning of the work of the component auditor:

- …

  …

Matters that are relevant to the conduct of the work of the component auditor:

- The findings of the group engagement team's tests of controls ~~activities~~ of a processing system that is common for all or some components, and tests of controls to be performed by the component auditor.
- …

ISA (NZ) 610 (Revised 2013), ***Using the Work of Internal Auditors***

Introduction

…

Relationship between ISA (NZ) 315 (Revised 2019) and ISA (NZ) 610 (Revised 2013)

…

7. ISA (NZ) 315 (Revised 2019) addresses how the knowledge and experience of the internal audit function can inform the external auditor's understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, and identification and assessment of risks of material misstatement. ISA (NZ) 315 (Revised 2019)[3] also explains how effective communication between the internal and external auditors also creates an environment in which the external auditor can be informed of significant matters that may affect the external auditor's work.

…

Application and Other Explanatory Material

Definition of Internal Audit Function (Ref: Para. 2, 14(a))

...

A3. In addition, those in the entity with operational and managerial duties and responsibilities outside of the internal audit function would ordinarily face threats to their objectivity that would preclude them from being treated as part of an internal audit function for the purpose of this ISA (NZ), although they may perform controls ~~activities~~ that can be tested in accordance with ISA (NZ) 330.[12] For this reason, monitoring controls performed by an owner-manager would not be considered equivalent to an internal audit function.

A4. While the objectives of an entity's internal audit function and the external auditor differ, the function may perform audit procedures similar to those performed by the external auditor in an audit of financial statements. If so, the external auditor may make use of the function for purposes of the audit in one or more of the following ways:

- To obtain information that is relevant to the external auditor's assessments of the risks of material misstatements due to error or fraud. In this regard, ISA (NZ) 315 (Revised 2019)[102] requires the external auditor to obtain an understanding of the nature of the internal audit function's responsibilities, its status within the organisation, and the activities performed, or to be performed, and make enquiries of appropriate individuals within the internal audit function (if the entity has such a function); …

…

Evaluating the Internal Audit Function

…

Application of a Systematic and Disciplined Approach (Ref: Para. 15(c))

A10. The application of a systematic and disciplined approach to planning, performing, supervising, reviewing and documenting its activities distinguishes the activities of the internal audit function from other monitoring controls ~~activities~~ that may be performed within the entity.

…

A21. As explained in ISA (NZ) 315 (Revised 2019),[103] 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.

…

A26. ISA (NZ) 200[104] discusses the importance of the auditor planning and performing the audit with professional scepticism, including being alert to information that brings into question the reliability of documents and responses to enquiries to be used as audit evidence. Accordingly, communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring matters that may affect the work of the external auditor to the external auditor's attention.[105] The external auditor is then able to take such information into account in the external auditor's identification and assessment of risks of material misstatement. In addition, if such information may be indicative of a heightened risk of a material misstatement of the financial statements or may be regarding

[102] ISA (NZ) 315 (Revised 2019), paragraph ~~6~~14(a).

[103] ISA (NZ) 315 (Revised 2019), paragraph 12(l)

[104] ISA (NZ) 200, paragraphs 15 and A18.

[105] ISA (NZ) 315 (Revised 2019), paragraph ~~A116~~A118.

any actual, suspected or alleged fraud, the external auditor can take this into account in the external auditor's identification of risk of material misstatement due to fraud in accordance with ISA (NZ) 240.[106]

…

ISA (NZ) 620, *Using the Work of an Auditor's Expert*

Application and Other Explanatory Material

…

Determining the Need for an Auditor's Expert (Ref: Para. 7)

A4. An auditor's expert may be needed to assist the auditor in one or more of the following:

- Obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the~~, including its~~ entity's system of internal control.
- …

ISA (NZ) 701, *Communicating Key Audit Matters in eth Independent Auditor's Report*

Application and Other Explanatory Material

…

Determining Key Audit Matters (Ref: Para. 9–10)

…

Considerations in Determining Those Matters that Required Significant Auditor Attention (Ref: Para. 9)

9. The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following: (Ref: Para. A9–A18)

a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA (NZ) 315 (Revised 2019).[107] (Ref: Para. ~~A19–A22~~ A39–A43)…

…

Areas of Higher Assessed Risk of Material Misstatement, or Significant Risks Identified in Accordance with ISA (NZ) 315 (Revised 2019) (Ref: Para. 9(a))

…

106 ISA (NZ) 315 (Revised 2019), paragraph A11 in relation to ISA (NZ) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.*

107 ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~*.

A20. ISA (NZ) 315 (Revised 2019) 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 the inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur ~~that, in the auditor's judgement, requires special audit consideration~~.[108] 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.

…

A22. ISA (NZ) 315 (Revised 2019) explains that the auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained.[109] …

…

ISA (NZ) 720 (Revised), ***The Auditor's Responsibilities Relating to Other Information***

Application and Other Explanatory Material

…

Reading and Considering the Other Information (Ref: Para. 14–15)

…

Considering Whether There Is a Material Inconsistency between the Other Information and the Auditor's Knowledge Obtained in the Audit (Ref: Para. 14(b))

…

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 ISA (NZ) 315 (Revised 2019).[110] ISA (NZ) 315 (Revised 2019) 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 r~~Relevant industry, regulatory, and other external factors;

(c) The relevant measures used, internally and externally, to assess ~~measurement and review of~~ the entity's financial performance;~~ and~~

108 ISA (NZ) 315 (Revised 2019), paragraph 12(l)

109 ISA (NZ) 315 (Revised 2019), paragraph ~~31~~37.

110 ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~*, paragraphs 19~~11~~–27~~12~~

~~(b) The nature of the entity;~~

~~(c) The entity's selection and application of accounting policies;~~

~~(d) The entity's objectives and strategies;~~

…

Responding When a Material Misstatement in the Financial Statements Exists or the Auditor's Understanding of the Entity and Its Environment Needs to Be Updated (Ref: Para. 20)

A51. In reading the other information, the auditor may become aware of new information that has implications for:

- The auditor's understanding of the entity and its environment, the financial reporting framework and the entity's system of internal control and, accordingly, may indicate the need to revise the auditor's risk assessment.
- …

NZ AUDITING AND ASSURANCE STANDARDS BOARD

Memorandum

Date:	13 February 2020
To:	Michele Embling, Chair XRB Board
From:	Robert Buchanan, Chairman NZAuASB
Subject:	Certificate Signing Memo: International Standard on Auditing (New Zealand) ISA (NZ) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement* and *Conforming and Consequential Amendments Arising from ISA (NZ) 315 (Revised 2019)*

Introduction

1. In accordance with the protocols established by the XRB Board, the NZAuASB seeks your approval to issue International Standard on Auditing (New Zealand) (ISA (NZ)) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement* and *Conforming and Consequential Amendments Arising from ISA (NZ) 315 (Revised 2019).*

Background

International process

2. The IAASB's Post-Implementation Review of the Clarified International Standards on Auditing[1], completed in 2013, identified the following issues in relation to the ISA 315 (Revised):
   - Inconsistencies in the number and nature of significant risks being identified;
   - The nature and extent of work to be performed on internal control relevant to the audit, including information technology controls, in particular where information technology systems are complex or the auditor does not intend to rely on controls as part of the audit;
   - Practically identifying risks of material misstatements at the assertion level; and
   - Documentation of risk assessment procedures in identifying and assessing the risk of material misstatement.

   In addition, it has been identified from the ISA Implementation Monitoring project and by others, including respondents to the IAASB's Stakeholder Survey on its future strategy and work plan, and NSS, that the requirements and guidance in ISA 315 (Revised) has not

1 https://www.iaasb.org/projects/isa-implementation-monitoring

been updated for evolving environmental influences (such as changing internal control frameworks and more advanced technology systems being utilized).

3. Consequently, the IAASB consultations in developing its Strategy for 2015-2019[2] and related Work Plan for 2015-2016[3] indicated a need for the International Auditing and Assurance Standards Board (IAASB) to take action to address issues relevant to the application of ISA 315 (Revised).
4. In its June 2016 meeting, the IAASB directed the ISA 315 (Revised) Working Group to present a project proposal for the IAASB's consideration at its September 2016 meeting to commence standard-setting activities. The project proposal[4] was presented and approved in the IAASB's September 2016 meeting.
5. The IAASB issued for public comments its exposure draft (ED) of proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*, in July 2018 with comments due on 2 November 2018.
6. The ED required a more robust risk assessment process and intended to achieve the following objectives:
    - Emphasise the complexity and iterative nature of the standard
    - Improve scalability of the standard
    - Modernising and updating the ISA for an evolving business environment
    - Better explain how automated tools and techniques may be used in risk assessment process
    - To provide a better foundation for auditors work around understanding an entity's use of IT in its business and system of internal controls.
    - Fostering independence of mind and professional scepticism
    - How fraud is considered as part of the risk assessment process
7. The IAASB received seventy-two responses to ED-315 from a broad range of stakeholders. An overarching theme throughout the responses related to the complexity of the proposals, as well as the scalability and proportionality of the proposed standard. There were also many comments related to individual aspects of the proposals, some

2 http://www.ifac.org/system/files/publications/files/IAASB-Strategy-2015-2019_0.pdf

3 http://www.ifac.org/system/files/publications/files/IAASB-Work-Plan-2015-2016.pdf

4 http://www.iaasb.org/system/files/meetings/files/20160912-IAASB_CAG_Agenda_Item_D-ISA-315-Revised_Cover-final.pdf

supporting the specific changes that had been proposed, while other comments highlighted concerns or disagreement.

8. In response to the comments received from all respondents, significant amendments to the ED and related conforming amendments were made. Appendix A includes detailed of changes made.
9. The IAASB considered the need for re-exposure of the standard. Those board members in favour of re-exposure noted that some of the changes to the standard since the exposure draft were more substantive in nature, including:
   - Change in the drafting style of the standard, which results in substantively different understanding and application of the standard.
   - Re-wording of the definitions, which may be seen to change the meaning of the definition.
   - Introduction of new definitions, such as 'risks arising from IT,' which is a new concept since the exposure draft.

   Board members in favour of re-exposure also challenged the ISA 315 Task Force as to whether the revised standard addresses respondents' concerns over scalability, complexity and understandability.

   Board members who were against re-exposure noted that the changes made since exposure were more about the presentation of the standard and therefore did not change the meaning of the words (for example words in tables could be read in the same way if there were no tables) or were in response to comments received on exposure. They highlighted that the public interest would not be served by re-exposure as this would delay the important improvements to a foundational standard.

   The IAASB voted against re-exposure, with 13 Board members voting against re-exposure out of the 18 Board members present.

10. ISA 315 (Revised 2019) was approved with affirmative votes of 15 out of 18 IAASB members, and the conforming and consequential amendments were approved with the affirmative votes of 16 out of 18 IAASB members.

11. The IAASB members who voted against the approval provided the following reasons for their disagreement.

    - The Board and the ISA 315 Task Force has not addressed the issue of complexity and understandability with the drafting approach in the final standard. Several of the sentences in the requirements were very long, complex and not written in plain English. In addition, application materials were very long, which made it difficult for the readers to understand the whole picture of the standard. Therefore, it would likely impact the ability of users of the standard to properly implement the standard which would not be in the public interest.

- The adopted drafting approach would also make it difficult to translate to other languages especially where the language structure is different from English.
- The requirements, as drafted, remain insufficiently clear, in their own right, as to what is expected of the auditor. the complexity of the definitions and how they interact with the risk assessment requirements, in particular paragraph 45 had remained confusing and would therefore likely result in inconsistent interpretation in practice. In addition, although some matters raised had been addressed, others, such as the purpose of the evaluations related to the components of the system of internal control, still lacked clarity.
- One member abstained from voting as he was unable to reach a conclusion about the process to finalize the standard in light of the many changes that had been made and was therefore unable to reach a conclusion to form a position to vote.

12. The revised ISA will be effective for audits of financial statements for periods beginning on or after December 15, 2021. The final standard was issued in December 2019.

Privacy

13. The Financial Reporting Act 2013, section 22(2) requires that the External Reporting Board consult with the Privacy Commissioner where an accounting or assurance standard is likely to require the disclosure of personal information. No such consultation is required in relation to this standard.

Domestic process and harmonisation with Australia

14. The NZAuASB sought feedback from constituents on the IAASB's ED through round table discussions held on 6 September 2018 in Auckland and 30 August 2018 in Wellington. Participants at the combined round table discussions represented the following: OAG, CAANZ, FMA, PWC, EY, KPMG, Grant Thornton, Staples Rodway and RSM. No formal submission was received.
15. On 16 August 2018, the NZAuASB jointly hosted a 90-minute webinar with the Australian Auditing and Assurance Standards Board in relation to ED-315. Fiona Campbell, IAASB

Member and Chair of the ISA 315 Task Force explained the key revisions to the auditor's risk assessment procedures, as introduced through the recently published ISA 315 Exposure Draft.

16. The NZAuASB's submission to the IAASB was prepared based on feedback received from the round table discussions and the Board at its September 2018 meeting.
17. The NZAuASB did not identify any compelling reason amendments, except for one amendment carried forward from the Extant standard[5], to include in ISA (NZ) 315 (Revised). The usual New Zealand terminology and spelling changes were made to the international standard.
18. Except for the conforming amendment noted in paragraph 17, there are no harmonisation differences between New Zealand and Australia in relation to this standard.

Due process

19. The due process followed by the NZAuASB complied with the due process requirements established by the XRB Board and in the NZAuASB's view meets the requirements of section 12(b) of the Financial Reporting Act 2013.

Consistency with XRB Financial Reporting Strategy

20. The adoption of International Standard on Auditing (New Zealand) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement* and *Conforming and Consequential Amendments Arising from ISA (NZ) 315 (Revised)* is consistent with one of the key strategic objectives set by the XRB Board for the NZAuASB to adopt international auditing and assurance standards, as applying in New Zealand unless there are compelling reasons not to.

Other matters

21. There are no other matters relating to the issue of this standard that the NZAuASB considers to be pertinent or that should be drawn to your attention.

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[5] NZ A1.1 was amended by the NZAuASB to be consistent with changes made by the NZAuASB within ISA (NZ) 580, Written Representations. To remain consistent with the changes previously made in New Zealand to ISA (NZ) 580, the NZAuASB included a reference to management and where relevant those charged with governance when obtaining written representations (paragraph A51 of ISA (NZ) 315).

Recommendation

22. The NZAuASB recommends that you sign the attached certificate of determination on behalf of the XRB Board.

Attachments

International Standard on Auditing (New Zealand) ISA (NZ) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

Conforming and Consequential Amendments Arising from ISA (NZ) 315 (Revised)

Appendix A: IAASB's significant amendments to the ED

Robert Buchanan

Chair NZAuASB

NZ AUDITING AND ASSURANCE STANDARDS BOARD

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	5.1
Meeting date:	12 February 2020
Subject:	IESBA – Non- Assurance Services and Fees
Date:	28 January 2020
Prepared By:	Sharon Walker

X **Action Required**	☐ **For Information Purposes Only**

Agenda Item Objectives

1. To provide the Board with an outline of the proposed outreach activities with respect to the IESBA fees and non-assurance services exposure drafts.

Background

2. The IESBA has released two exposure drafts, approved in December 2019:
   - Proposed Revisions to the Non-Assurance Services (NAS) Provisions of the Code
   - Proposed Revisions to the Fee-Related Provisions of the Code
3. The EDs are aimed at strengthening the non-assurance services and fee-related independence provisions of the International Code of Ethics for Professional Accountants, including International Independence Standards.
4. Key changes proposed to the NAS provisions are:
   - A prohibition on providing NAS to an audit client that is a public interest entity if a self-review threat to independence will be created;
   - Further tightening of the circumstances in which materiality may be considered in determining the permissibility of a NAS;
   - Strengthened provisions regarding auditor communication with those charged with governance, including, for public interest entities, a requirement for NAS pre-approval by those charged with governance; and
   - Stricter requirements regarding the provision of some NAS, including certain tax and corporate finance advice.
5. Key changes proposed to the fee-related provisions include:
   - A prohibition on firms allowing the audit fee to be influenced by the provision of services other than audit to the audit client;

- In the case of public interest entities, a requirement to cease to act as auditor if fee dependency on the audit client continues beyond a specified period; and
- Communication of fee-related information to those charged with governance and to the public to assist their judgements about auditor independence.

6. The Board received an update and provided feedback on the key proposals at its December 2019 meeting. For more information on the proposals, the exposure drafts are available on the IESBA website. We will be discussing the proposals in more detail at the April meeting where we will seek the Board's approval of the submissions.

Outreach Activities

7. We are planning to undertake the following outreach activities to ensure relevant stakeholders are aware of the proposals and to encourage them to make submissions either directly to the IESBA or the NZAuASB.
8. Proposed outreach activities:

Action	Audience	Timing
Issue IESBA EDs in New Zealand via newsletter, inviting comment	All stakeholders	Late January
Sylvie Soulier breakfast	All stakeholders	Friday 31 January
Roundtables – Auckland and Wellington	Practitioners, regulator, directors	TBA March
One on one targeted meetings	Auditor-General, FMA	February

9. Depending on the feedback from the roundtables, we may perform more targeted outreach.
10. We are also aware that the IESBA is planning to do a webinar and that the APESB is planning a Q&A session with Sylvie that will be recorded and that we will be able to share with our stakeholders. We intend to liaise with CA ANZ as well to discuss their outreach plan.

Recommendation

11. We recommend that the Board provide us with comments on the NZAuASB proposed outreach plan.

Material Presented

Agenda item 5.1 Board Meeting Summary Paper

NZ AUDITING AND ASSURANCE STANDARDS BOARD

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	6.1
Meeting date:	12 February 2020
Subject:	Amendment to ISA (NZ) 560
Date:	21 January 2020
Prepared By:	Sharon Walker

X **Action Required**	☐ **For Information Purposes Only**

Agenda Item Objectives

1. The objective of this agenda item is to:

   - APPROVE *Amendments to Standards Issued by the NZAuASB: ISA (NZ) 560 Subsequent events* to clarify the timing of communications and possible actions the auditor may take when facts become known to the auditor after the financial statements have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report.
   - APPROVE the draft signing memorandum

Background

2. ED NZAuASB 2019-2 *Amendments: ISA (NZ) 560 Subsequent Events* was issued as an exposure draft in November 2019 with a 30-day exposure period.
3. The exposure period closed on 13 December 2019. No submissions were received.
4. There are no changes to the proposed amendments.

Effective Date

5. Given the limited nature of the changes, we recommend this standard be effective for periods beginning on or after 15 September 2020.

Recommendation

6. We recommend the Board APPROVE the final standard and related signing memorandum.

Material Presented

7. The following materials are presented:

Agenda item 6.1	BMSP
Agenda item 6.2	Amending Standard
Agenda item 6.3	Signing Memorandum

AMENDMENT TO STANDARDS ISSUED BY THE NZAuASB: ISA(NZ) 560 SUBSEQUENT EVENTS

This Standard was issued on 1 March 2020 by the New Zealand Auditing and Assurance Standards Board of the External Reporting Board pursuant to section 12(b) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 28 March 2020.

An auditor that is required to apply the amendment in this Standard is required to apply it for audits of financial statements for periods beginning on or after 15 September 2020. However, early adoption in permitted.

In finalising this Standard, the New Zealand Auditing and Assurance Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Standard has been issued to clarify the auditor's responsibility to communicate matters that become known to the auditor after the date of the auditor's report.

ISBN

Amendment to Standards Issued by the NZAuASB: ISA (NZ) 560 Subsequent Events

CONTENTS

A: INTRODUCTION

This document sets out amendments to ISA (NZ) 560, *Subsequent Events,* to address concerns raised by the Financial Markets Authority about how to ensure that investors and other stakeholders are informed in a timely manner that they cannot rely on the audit opinion, when a fact becomes known to the auditor after the financial statements have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the report.

Amended paragraphs are shown with new text underlined and deleted text struck through.

The footnote numbers within these amendments do not align with the ISA (NZ) 560 and reference should be made to ISA (NZ) 560.

B: Amendments to International Standard on Auditing (New Zealand) 560

Requirements

…

Facts Which Become Known to the Auditor after the Financial Statements Have Been Issued

14. *Amended by the NZAuASB*

NZ 14.1 After the financial statements have been issued, the auditor has no obligation to perform any audit procedures regarding such financial statements. However, if, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall: **(Ref: Para. A18)**

(a) Discuss the matter with management and, where appropriate, those charged with governance within a reasonable period of time;

(a) Determine whether the financial statements need amendment; and, if so,

(b) Enquire how management intends to address the matter in the financial statements.

15. If management amends the financial statements, the auditor shall: **(Ref: Para. A19)**

(a) Carry out the audit procedures necessary in the circumstances on the amendment.

(b) Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation.

(c) Unless the circumstances in paragraph 12 apply:

(i) Extend the audit procedures referred to in paragraphs 6 and 7 to the date of the new auditor's report and date the new auditor's report no earlier than the date of approval of the amended financial statements; and

(ii) Provide a new auditor's report on the amended financial statements.

(d) When the circumstances in paragraph 12 apply, amend the auditor's report or provide a new auditor's report as required by paragraph 12.

16. The auditor shall include in the new or amended auditor's report an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor.

17. If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity[1], those charged with governance that the auditor will seek to prevent future reliance on the auditor's report. If, despite such notification, management

[1] ISA 260, "Communication with Those Charged with Governance," paragraph 13.

or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report. **(Ref: Para. A20-NZ A20.1)**

***

Application and Other Explanatory Material

…

Facts Which Become Known to the Auditor after the Financial Statements Have Been Issued

Implications of Other Information Received after the Financial Statements Have Been Issued (Ref: Para. 14)

A18. The auditor's obligations regarding other information received after the date of the auditor's report are addressed in ISA (NZ) 720 (Revised). While the auditor has no obligation to perform any audit procedures regarding the financial statements after the financial statements have been issued, ISA (NZ) 720 (Revised) contains requirements and guidance with respect to other information obtained after the date of the auditor's report.

No Amendment of Financial Statements by Management (Ref: Para. 15)

Considerations Specific to Public Sector Entities

A19. In some jurisdictions, entities in the public sector may be prohibited from issuing amended financial statements by law or regulation. In such circumstances, the appropriate course of action for the auditor may be to report to the appropriate statutory body.[2]

Auditor Action to Seek to Prevent Reliance on Auditor's Report (Ref: Para. 17)

A20. Where the auditor believes that management, or those charged with governance, have failed to take the necessary steps to prevent reliance on the auditor's report on financial statements previously issued by the entity despite the auditor's prior notification that the auditor will take action to seek to prevent such reliance, the auditor's course of action depends upon the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

NZ A20.1 Unless legal advice obtained recommends a different course of action, possible actions the auditor may consider include:

(a) Notifying management and those charged with governance that the auditor's report must no longer be associated with the financial statements;

(b) If applicable, notifying the appropriate authority having jurisdiction over the entity that the auditor's report should no longer be relied upon, and requesting the authority to take steps to provide appropriate disclosure.

(c) If practicable, notifying each person known to the auditor to be relying on the financial statements that the auditor's report should no longer be relied upon.

[2] This is unlikely to be the case in New Zealand.

D. Effective Date

An auditor that is required to apply the amendment in this Standard is required to apply it for audits of financial statements for periods beginning on or after 15 September 2020. However, early adoption is permitted.

NZ AUDITING AND ASSURANCE STANDARDS BOARD

Memorandum

Date: 12 February 2020

To: Michele Embling, Chairman XRB Board

From: Robert Buchanan, Chairman NZAuASB

Subject: Certificate Signing Memo: *Amendments to Standards Issued by the NZAuASB: ISA (NZ) 560 Subsequent Events*

Introduction

1. In accordance with the protocols established by the XRB Board, the NZAuASB seeks your approval to issue *Amendments to Standards Issued by the NZAuASB: ISA (NZ) 560 Subsequent Events*.

Background

2. The NZAuASB issued the exposure draft, Amendment: ISA (NZ) 560 *Subsequent Events* to address a concern raised by the Financial Markets Authority (FMA). The concern related to clarity around the timing of the auditor's communication to users that they cannot rely on the audit opinion, and the actions the auditor may take to inform users, when a fact becomes known to the auditor after the financial statements have been issued that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report.

3. The exposure draft was issued with a limited 30-day exposure period as the matters dealt with are minor. EG Au2 *Overview of Auditing and Assurance Standard Setting Process* allows for a shorter comment period in certain circumstances provided the exposure period is not less than 30 days, as follows: "The comment period can vary depending on the complexity of the topic, but is typically 90 days. Shorter comment periods are used only for urgent or minor matters and will never be less than 30 days."

4. No submissions were received on the proposals.

5. The Financial Reporting Act 2013, section 22(2) requires that the External Reporting Board consult with the Privacy Commissioner where an accounting or assurance

standard is likely to require disclosure of personal information. The amendments do not require such disclosure.

6. The due process followed by the NZAuASB complied with the due process requirements established by the XRB Board and in the NZAuASB's view meets the requirements of section 12(b) of the Financial Reporting Act 2013.

Consistency with XRB Financial Reporting Strategy

7. The key strategic objectives set by the XRB Board for the NZAuASB include:

   - To adopt international auditing and assurance standards, including the professional and ethical standards, in New Zealand unless there are strong reasons not to (which the Board describes as "compelling reasons"); and

   - To work with the Australian Auditing and Assurance Standards Board (AUASB) towards the establishment of harmonised standards based on international standards.

8. Modifications for the application in New Zealand may be acceptable provided such modifications consider the public interest, and do not conflict with or result in lesser requirements than the international standards.

9. The modification seeks to clarify the international standard to address concerns of the FMA that the international standard is not clear as to the timing of the required communication or possible actions the auditor may take to inform users that the report is not to be relied upon. The AUASB is considering making a similar change to their standard.

Other matters

10. There are no other matters relating to the issue of this standard that the NZAuASB considers to be pertinent or that should be drawn to your attention.

Recommendation

11. The NZAuASB recommends that you sign the attached certificate of determination on behalf of the XRB Board.

Attachments

Amendments to Standards Issued by the NZAuASB: ISA (NZ) 560 Subsequent Events

Robert Buchanan

Chair NZAuASB

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	31 January 2020
To:	NZAuASB Members
From:	Lisa Kelsey
Subject:	**Primary Financial Statements**

Purpose and introduction[1]

1. In December 2019 the IASB issued Exposure Draft ED/2019/7 *General Presentation and Disclosures* (the ED) under their *Primary Financial Statements* project. The ED proposes to introduce a new IFRS Standard that sets out general presentation and disclosure requirements. The proposed new standard will replace IAS 1 *Presentation of Financial Statements*.

2. The IASB's *Primary Financial Statements* project is a high priority project for the NZASB and the NZASB has agreed to comment on the ED. To help inform its submission the NZASB is undertaking outreach with various stakeholders. As part of our outreach plan, we are consulting with the Board[2] on proposals relating to Management Performance Measures (also referred to as non-GAAP or alternative performance measures (APMs)) and 'unusual' income and expenses.

Recommendations

3. The Board is asked to CONSIDER and PROVIDE FEEDBACK on the IASB's proposals to:
   (a) introduce requirements for entities to disclose information about Management Performance Measures (MPMs) in a single note to the financial statements; and
   (b) require entities to identify and disclose in the notes to the financial statements 'unusual' income and expenses.

Background

4. The *Primary Financial Statements* (PFS) project was added to the IASB's research work plan in December 2016 in response to feedback on the IASB's 2015 Agenda Consultation. The project was moved to the IASB's standard-setting work plan in September 2018.

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

[2] All references to the Board in this memo should be read to mean the NZAuASB.

5. The PFS project is part of the IASB's broader theme of *Better Communication in Financial Reporting*.

6. The PFS project proposes targeted improvements to the structure and content of the primary financial statements. The main focus of the improvements is the statement of profit or loss.

7. As mentioned earlier, the ED proposes a new IFRS Standard that will replace IAS 1. The proposed new standard comprises new requirements on the structure and content of the financial statements plus related requirements brought forward from IAS 1 with limited wording changes.

8. The table below highlights key proposals in the ED and expected benefits.

Key proposals in the ED & expected benefits

	Key proposals	User concerns	Expected benefits of proposals
1	Introduce defined **subtotals and categories** in the statement of profit or loss	Structure and content of statements of profit or loss varies between different entities, making it difficult to compare entities' performance	Additional relevant information and a P&L structure that is more comparable between entities
2	Introduce requirements to improve **aggregation** and **disaggregation**	Level of disaggregation does not always provide the information they need	Additional relevant information and material information not being obscured
3	Introduce **Management Performance Measures (MPMs)** and accompanying disclosures in financial statements	Non-GAAP measures can provide useful information, but transparency and discipline need to be improved	Transparency & discipline in use of such measures Disclosures in a single location
4	Introduce targeted improvements to the **statement of cash flows**	Classification and presentation options make it more difficult to compare entities	Improved comparability between entities

Structure of this memo

9. The remaining sections in this memo are:

   (a) Non-GAAP performance measures;

      (i) New Zealand;

      (ii) Internationally;

      (iii) Regulators;

      (iv) FMA Guidance;

   (b) IASB proposals on MPMs; and

   (c) IASB proposals on unusual income and expenses.

Non-GAAP performance measures

New Zealand

10. The XRB conducted a survey *Alternative Performance Measures (APMs): A New Zealand user-needs survey*[3] via an online questionnaire between November 2016 and January 2017. The aim of the survey was to better understand how APMs are viewed and whether they are effective in meeting the information needs of users of financial reports in New Zealand.

11. Some of the results are as follows.

    (a) 88.5% of respondents found APMs useful or sometimes useful.

    (b) Respondents use APMs to clarify, understand and assess a company's business, underlying performance and future prospects.

    (c) APMs are widely used, but also subject to a few caveats, with respondents wanting to understand why they are being used and how they have been calculated.

    (d) Respondents felt APMs should be reconciled or explained against GAAP measures.

    (e) 74.7% of respondents think APMs should be assured.

12. In June 2017, PWC published a research paper *An alternative picture to performance*[4]. PWC set out to explore how widely APMs are used and what is being adjusted by the NZX 50 companies. They summarised their findings as follows.

    (a) 92% of the NZX 50 presented an adjusted GAAP profit number.

    (b) Adjustments almost always have a favourable impact on profit.

    (c) Companies commonly adjust for fair value movements, asset impairment and depreciation, amortisation, interest and tax.

    (d) Descriptions of reconciling items are often too broad to understand what they relate to.

    (e) Companies use inconsistent approaches as to where and how reconciliations are presented.

Internationally

13. The IASB has published on its website an academic overview of the PFS project.[5] The article was written by IASB members Ann Tarca and Tom Scott. The article notes:

    > Users support enhancing the quality of adjusted earnings measures, while at the same time limiting opportunistic behaviour. A recent survey of CFA[6] Institute members reported that the majority of respondents (63%) held the view that management's alternative performance measures should be regulated; 59% of respondents expected that standard-setters should set standards for such measures. CFA Institute members also strongly support reporting such additional performance measures in financial statements where they would be subject to audit, which should also result in enhanced internal controls.

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3 https://www.xrb.govt.nz/information-hub/current-research-reports/

4 https://www.pwc.co.nz/pdfs/an-alternative-picture-of-performance.pdf

5 https://www.ifrs.org/academics/academic-overview-of-the-primary-financial-statements-project/

6 Chartered Financial Analyst

14. The IASB is aware that many entities disclose non-GAAP/management-defined performance measures outside the financial statements – they have received feedback that users find such information useful because it provides insight into:

    (a) how management views the entity's financial performance;

    (b) how a business is managed; and

    (c) the persistence or sustainability of an entity's financial performance.

    However, the IASB notes that users have expressed concerns about the quality of the disclosures provided about these measures – in some cases, the disclosures:

    (a) lack transparency in how the management performance measures are calculated;

    (b) lack clarity regarding why these measures provide management's view of the entity's performance;

    (c) create difficulties for users trying to reconcile the measures to the related measures included in IFRS Standards; and

    (d) are reported inconsistently from period to period.

Regulators

15. At present, in many jurisdictions the national securities regulator has provided guidance or requirements for entities that report non-GAAP measures. However, the guidance/requirements can vary across jurisdictions and the measures, along with any related disclosures (such as reconciliations back to IFRS/GAAP totals), are not normally presented within the financial statements are therefore not subject to audit.

16. In June 2016, the International Organisation of Securities Commissions (IOSCO) released a statement on non-GAAP financial measures.[7] Many security regulators in those jurisdictions that are members of IOSCO, including the FMA, sought to align their guidance/requirements with the principles in the IOSCO statement.

FMA guidance

17. The FMA issued its guide *Disclosing non-GAAP financial information* in July 2017. The guidance replaced the *2012 Guidance note: Disclosing non-GAAP financial information* to reflect the requirements of the Financial Markets Conduct Act 2013 (FMC Act) and the FMA's findings from the review of non-GAAP financial information since 2012.

18. The 2017 guidance sets out the FMA's expectations on the use of financial information outside of the financial statements, where that information is not prepared and presented in accordance with generally accepted accounting practice (GAAP) or is presented as an alternative to statutory profit.

19. The FMA's guidance is aligned with the principles in the IOSCO statement, except where those principles were inappropriate (or inadequate) for the New Zealand market.

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7 https://www.iosco.org/library/pubdocs/pdf/IOSCOPD532.pdf

20. The FMA's guidance is broadly aligned with the IASB's proposals. For those Board members interested, we have provided a comparison between the IASB's proposed requirements and the FMA's guidance in Appendix 2 of this memo.

IASB proposals on MPMs

21. The IASB is of the view that MPMs can complement measures required by IFRS Standards, providing users of financial statements with useful insight into management's view of performance and its management of the business. Requiring the disclosure of information about these measures in the financial statements would:

    (a) ensure they are subject to the requirements in IFRS Standards regardless of the entity's jurisdiction and thus improve the discipline with which they are prepared and improve their transparency; and

    (b) subject the disclosures, which may have previously been provided outside of the financial statements, to audit – for entities with audit requirements.

22. The IASB has heard the following concerns about including MPMs in financial statements:

    (a) MPMs may be incomplete or biased;

    (b) MPMs may be given undue prominence or legitimacy by including them in financial statements; and

    (c) some adjustments made in arriving at MPMs may be difficult to audit—for example, adjustments made when an entity uses a tailormade accounting policy.

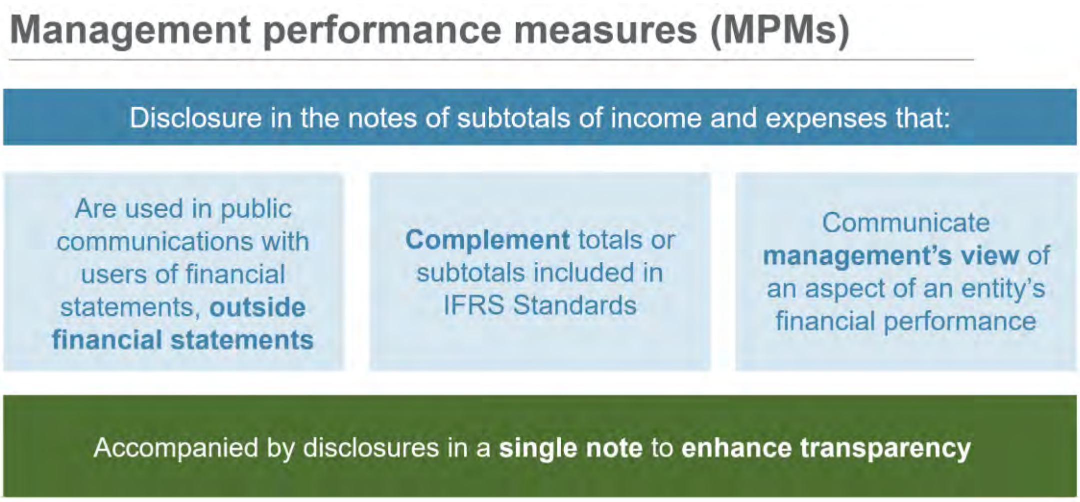
23. In response to the concerns above, the IASB noted that MPMs included in the financial statements:

    (a) would be subject to the general requirement for information to faithfully represent what it purports to represent, which would not be met if measures were misleading;

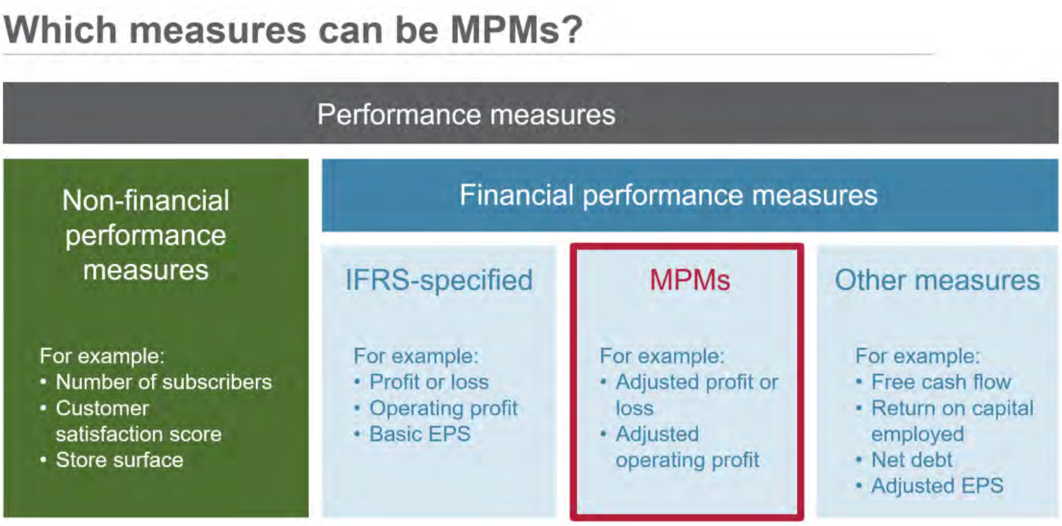
    (b) would rarely be presented on the face of the statement of profit or loss; and

    (c) are similar to segment measures of profit or loss in that they are based on management's view. Segment measures of performance are included in the financial statements and are audited.

24. The table below summarise the IASB's proposed definition of MPMs. The IASB's proposed definition for MPMs is limited to subtotals of income and expenses, this means that not all non-GAAP measures will be MPMs.



25. Examples of measures that can be MPMs are shown in the red box below. Non-financial performance measures (such as, customer retention rate), IFRS-specified measures and other measures (such as, currency adjusted revenue or return on capital employed) are not MPMs. The IASB has noted in the Basis for Conclusions of the ED that EBITDA measures may meet the definition of an MPM.



26. The IASB considered but rejected requiring MPMs to be based on amounts recognised and measured in accordance with IFRS Standards. The IASB noted that because MPMs will be company-specific measures, the IASB does not expect them to be comparable across companies. However, investors would be able to understand differences in how companies have calculated their measures using the proposed disclosures.

27. The IASB proposes that an entity disclose MPMs and all related information in a **single note** to the financial statements. Disclosing MPMs and the related information in a single location improves the transparency of those measures by:

    (a) providing management performance measures together with the information needed to understand those measures; and

    (b) helping users of financial statements to identify and locate the related information.

28. The table below summarises the proposed disclosure requirements.

MPMs—proposed disclosures in the notes

A description of **why the MPM provides management's view of performance**, including explanation of:
- **how** the MPM has been **calculated**; and
- **how** the measure provides **useful information** about an entity's financial performance.

A **reconciliation** of the MPM(s) to the **most directly comparable subtotal or total specified by IFRS Standards**

A statement that the MPM provides **management's view** of an aspect of the entity's financial performance and is **not necessarily comparable** with measures with a similar description provided by other entities

The **effect** of **tax and non-controlling interests** separately for each of the differences between the MPM and the most directly comparable subtotal or total specified by IFRS Standards.

If there is a **change** in how the MPM is calculated, explanation should be provided to help users understand the reasons for and effect of the change

29. For the purposes of the required reconciliation, 'subtotal or total specified by IFRS Standards' would include:

    (a) the three new subtotals;[8]

    (b) operating profit before depreciation and amortisation;

    (c) gross profit and similar subtotals, such as net interest income;

    (d) profit before tax; and

    (e) profit from continuing operations.

    Consequently, these subtotals would not be MPMs.

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8 The ED proposes to introduce three new defined subtotals into the statement of profit or loss. The proposed new subtotals are:

(a) operating profit or loss;

(b) operating profit or loss and share of profit or loss of integral associates and joint ventures; and

(c) profit or loss before financing and income tax.

30. We have provided the Board with relevant extracts from the ED of the requirements and integral application guidance in relation to the disclosure of MPMs in Appendix 1 of this memo. We also draw the Board's attention to the following.

    (a) The proposals include a requirement that MPMs shall faithfully represent aspects of the financial performance of the entity to users of the financial statements. Therefore, a management-defined performance measure that does not faithfully represent an aspect of an entity's performance should not be included in the financial statements as an MPM. The IASB acknowledges that including information about such measures in the financial statements may increase transparency about these measures. However, the IASB believes that all information included in the financial statements should provide a faithful representation of what it purports to represent.

    (b) The IASB is not proposing to prohibit entities from presenting MPMs as subtotals on the face of the statement of financial performance. The IASB noted that prohibiting an entity from presenting MPMs in the statement of financial performance may prevent an entity from complying with the requirement in IFRS Standards – to present additional line items, headings and subtotals when that information is relevant to an understanding of the entity's financial statements. However, the IASB expects that few MPMs would meet the requirements for presentation as a subtotal in the statement(s) of financial performance. To meet the requirements subtotals must:

        (i) fit into the structure of the proposed categories;

        (ii) not disrupt the presentation of an analysis of operating expenses by nature or by function; and

        (iii) be comprised of amounts recognised and measured applying IFRS Standards.

    (c) The IASB is proposing to prohibit entities from using columns to present MPMs on the face of the statement(s) of financial performance. This further restricts the circumstances in which such measures may be presented on the face of the statement(s) of financial performance.

    (d) An entity can have more than one MPM and may have no MPMs if any subtotals it uses to communicate its financial performance are specified by IFRS Standards.

    (e) The IASB is proposing that the income tax effect and the effect on non-controlling interests is disclosed for each item disclosed in the reconciliation (between each MPM and the most directly comparable subtotal or total specified by IFRS Standards). The IASB is proposing a simplified approach for calculating the tax effect.

Questions for Board

Q1. Do you agree that information about MPMs as defined by the IASB should be included in the financial statements? Why or why not?

Q2. Do you agree with the proposed disclosure requirements for MPMs? Why or why not? If not, what alternative disclosures would you suggest and why?

Q3. Do you have any other comments on the proposals relating to MPMs?

IASB proposals on unusual income and expenses

31. The IASB has observed that many entities disclose unusual or similarly described expenses (and a few disclose unusual income). However, the way entities disclose this information varies significantly and it is often not clear how or why items have been identified as unusual.

32. From a recent desktop review of a sample of NZX 50 entities, we observed the use of the following terms when describing expenses: non-recurring items, abnormal items, significant items and one-off items.

33. In 2017 the IASB issued a Discussion paper *Disclosure Initiative—Principles of Disclosure*. The Discussion paper explored how to improve the communication effectiveness of disclosures. The IASB received the following feedback in relation to the disclosure of unusual items.

    (a) Many users want requirements for the disclosure of unusual income or expenses because:

        (i) the separate presentation or disclosure of unusual or infrequent income or expenses provides information that is useful in making forecasts about future cash flows; and

        (ii) definitions and requirements developed by the IASB could make such income or expenses more transparent and comparable across entities and could reduce entities' opportunistic classification of expenses as unusual.

    (b) However, a few users commented that defining unusual or infrequent income and expenses may be difficult because they are entity-specific and identifying them would involve significant judgement.

    (c) Many respondents that are not users of financial statements said that the IASB should not develop definitions for 'unusual' or 'infrequent' income or expenses because those items vary across entities and industries and their identification involves significant judgement. They suggested that the Board could instead consider developing general requirements for the disclosure and faithful representation of such items, for example, requiring them to be classified and presented consistently over time and labelled in a clear and non-misleading way.

34. Responding to the above feedback the IASB is of the view that defining unusual items as income or expenses with limited predictive value:

    (a) addresses the needs of users of financial statements for information about items that are unlikely to persist and hence have limited predictive value; and

    (b) helps preparers of financial statements identify unusual items by providing them with a concept that underpins the need to identify unusual items.

35. The table below summarises the IASB's proposals in relation to the disclosure of unusual income and expenses.

Unusual income and expenses

Definition	Unusual income and expenses are income and expenses with limited predictive value. Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods. Income and expenses from the recurring remeasurement of items measured at a current value would not be expected to be classified as unusual	
Disclosures	Amount & narrative description	Disaggregated by: • line items presented in statement of profit or loss; and • line items disclosed in analysis of operating expenses by nature, if the entity analyses expenses by function in the statement of profit or loss

36. We have provided the Board with extracts from the ED of the requirements and integral application guidance in relation to the disclosure of unusual income and expenses in Appendix 1 of this memo. We would also like to draw the Board's attention to the following.

(a) The IASB proposes that information about unusual income and expenses should be disclosed in the notes rather than presented on the face of the statement(s) of financial performance.

(b) The IASB notes that its proposal for unusual income and expenses is different from the requirement for presentation of extraordinary items that was removed from IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in 2003. Extraordinary items were defined as clearly distinct from the ordinary activities of an entity and were presented in their own category after tax, separately from profit or loss from ordinary activities. Unusual income and expenses, on the other hand, are not separately classified in the statement(s) of financial performance from 'usual' income and expenses.

(c) The IASB considered specifying that information about unusual items should be neutral but rejected this as unnecessary because neutrality applies to all items included in the financial statements.

(d) The IASB did not indicate a specific period over which an entity should assess whether it is reasonable to expect that similar income or expenses will not arise.

(e) The IASB recognises that, when assessing whether income and expenses are unusual, it may be helpful to consider the nature of transactions or other events that gave rise to the income or expenses, for example, a big earthquake. However, a big earthquake may give rise to increased operating costs that are expected to arise for a number of years, and as such are not unusual expenses.

(f) The IASB proposes that an entity provides a description of the transactions or other events that gave rise to unusual income and expenses. The IASB considers this is useful because it enables users to understand what caused the unusual income or expense and to assess the entity's classification of the income and expense as unusual.

(g) The IASB proposes that recurring measurements of items measured at current value would not normally be classified as unusual, for example, gains or losses from fair value measurements.

37. The IASB noted that companies may choose to adjust for unusual items in the calculation of their MPMs. However, the IASB proposes that all companies should disclose all unusual items, regardless of whether they identify any MPMs or how their measures are calculated.

Questions for Board

Q4 Do you agree with the Board's proposed approach to defining and requiring the disclosure of unusual income and expenses? If not, what alternative approach would you suggest and why?

Q5 Do you agree with the proposed disclosure requirements for unusual income and expenses? Why or why not? If not, what alternative disclosure would you suggest and why?

Q6 Do you have any other comments on the proposals relating to the disclosure requirements for unusual income and expenses?

Next steps

38. We will collate feedback from the Board and share it with the NZASB to help inform their submission to the IASB.

Appendix 1

Extracts from the ED

Rather than provide the Board with the entire ED, we have included relevant extracts from the ED that relate to MPMs and unusual income and expenses. We have included both the requirements and the integral guidance (indicated by paragraph numbers beginning with B). We have also included in boxed text additional paragraphs from the ED that are referred to in the extracts.

Management performance measures

103 ***Management performance measures*** **are subtotals of income and expenses that (see paragraphs B76–B81):**

- **(a) are used in public communications outside financial statements;**
- **(b) complement totals or subtotals included in IFRS Standards; and**
- **(c) communicate to users of financial statements management's view of an aspect of an entity's financial performance.**

104 Subtotals specified by IFRS Standards that are not management performance measures include:

- (a) a total or subtotal required by paragraphs 60 and 73;
- (b) gross profit or loss (revenue less cost of sales) and similar subtotals (see paragraph B78);
- (c) operating profit or loss before depreciation and amortisation;
- (d) profit or loss from continuing operations; or
- (e) profit or loss before income tax.

> 60. [IAS 1.81A partial] Subject to paragraph 64, an entity shall present the following totals or subtotals in the statement of profit or loss:
>
> (a) operating profit or loss;
>
> (b) operating profit or loss and income and expenses from integral associates and joint ventures (see paragraph 53);
>
> (c) profit or loss before financing and income tax (see paragraphs 63–64); and
>
> (d) profit or loss.
>
> …
>
> 73. [IAS 1.81A partial] An entity shall present in the statement presenting comprehensive income totals for:
>
> (a) profit or loss;
>
> (b) total other comprehensive income; and
>
> (c) comprehensive income, being the total of profit or loss and other comprehensive income.

105 Management performance measures shall:

- (a) faithfully represent aspects of the financial performance of the entity to users of financial statements; and
- (b) be described in a clear and understandable manner that does not mislead users.

106 An entity shall disclose information about any management performance measures in a single note to the financial statements. That note shall include a statement that the management performance measures provide management's view of an aspect of the entity's financial performance and are not necessarily comparable with measures sharing similar descriptions provided by other entities. In addition, for each management performance measure an entity shall disclose in the notes (see paragraphs B82–B85):

- **(a) a description of why the management performance measure communicates management's view of performance, including an explanation of:**
  - **(i) how the management performance measure is calculated; and**

(ii) how the measure provides useful information about the entity's performance;

(b) a reconciliation between the management performance measure and the most directly comparable subtotal or total included in paragraph 104;

(c) the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation required by paragraph 106(b); and

(d) how the entity determined the income tax effect required by paragraph 106(c).

107 An entity shall determine the income tax effect required by paragraph 106(c) on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned or by another method that achieves a more appropriate allocation in the circumstances.

108 If an entity changes the calculation of its management performance measures, introduces a new management performance measure or removes a previously disclosed management performance measure from its financial statements, it shall: (a) disclose sufficient explanation for users of financial statements to understand the change, addition or removal and its effects; (b) disclose the reasons for the change, addition or removal; and (c) restate its comparative information, including in the required note disclosures, to reflect the change, addition or removal.

109 A subtotal included in the statement(s) of financial performance applying paragraph 42 may be a management performance measure (see paragraph B81).

42.	**[IAS 1.85, 55] This [draft] Standard requires minimum line items and subtotals to be presented in the statement(s) of financial performance and the statement of financial position. An entity shall present additional line items (including by disaggregating required minimum line items), headings and subtotals in the statement(s) of financial performance and the statement of financial position when such presentations are relevant to an understanding of the entity's financial performance or financial position.**

110 An entity shall not use columns to present management performance measures in the statement(s) of financial performance.

…

Identifying management performance measures

B76 Paragraph 103 defines management performance measures. Some entities may have more than one management performance measure. However, not all entities will have management performance measures. For example, if an entity publicly communicates its financial performance to users of its financial statements, using only totals and subtotals specified by IFRS Standards, it will not have a management performance measure.

B77 Paragraph 104 specifies subtotals that are not management performance measures. An entity is not required to provide the disclosures specified in paragraph 106 for these subtotals.

B78 In accordance with paragraph 104(b) subtotals similar to gross profit are not management performance measures. A subtotal is similar to gross profit when it represents the difference between a type of revenue and directly related expenses incurred in generating that revenue. Examples include: (a) net interest income; (b) net fee and commission income; (c) insurance service result; (d) net financial result (investment income minus insurance finance expenses); and (e) net rental income.

B79 Only subtotals that management uses in public communications outside financial statements, for example, in management commentary, press releases or in investor presentations, meet the definition of management performance measures.

B80 A management performance measure is a subtotal of income and expenses. Examples of measures that are not management performance measures include: (a) individual items or subtotals of only income or expenses (for example, adjusted revenue as a stand-alone measure); (b) assets, liabilities, equity or combinations of these elements; (c) financial ratios (for example, return on assets); (d) measures of growth; (e) measures of liquidity or cash flows (for example, free cash flow); or (f) non-financial performance measures.

B81 A subtotal presented in the statement(s) of financial performance to comply with paragraph 42 may meet the definition of a management performance measure. When such a subtotal meets that definition, an entity shall disclose all the information required by paragraph 106.

Management performance measures note disclosure

B82 All information required to be disclosed about management performance measures shall be included in a single note.

B83 In some cases, one or more of an entity's management performance measures may be the same as part of the operating segment information disclosed by the entity in applying IFRS 8. In such cases, the entity may disclose the required information about those management performance measures in the same note that it uses to disclose information about its operating segments provided the entity either:

(a) includes in that note all of the information required by paragraph 106 for management performance measures; or

(b) provides a separate note that includes all of the information required for management performance measures.

B84 Paragraph 106(a)(i) requires an explanation of how a management performance measure is calculated. To comply with this requirement an entity shall explain the specific principles, bases, conventions, rules and practices it applies in calculating its management performance measures.

B85 Paragraph 106(b) requires an entity to reconcile its management performance measure(s) to the most directly comparable subtotal or total specified by IFRS Standards. For example, an entity that discloses in the notes adjusted operating profit or loss as a management performance measure would reconcile to operating profit or loss as the most directly comparable subtotal. In aggregating or disaggregating the reconciling items disclosed an entity shall apply the requirements in paragraphs 25–28.

25 [IAS 1.29 and IAS 1.30A] An entity shall present in the primary financial statements or disclose in the notes the nature and amount of each material class of assets, liabilities, income or expense, equity or cash flow. To provide this information an entity shall aggregate transactions and other events into the information it discloses in the notes and the line items it presents in the primary financial statements. Unless doing so would override specific *aggregation* or disaggregation requirements in IFRS Standards, an entity shall apply the principles that (see paragraphs B5–B15):

(a) items shall be classified and aggregated on the basis of shared characteristics;

(b) items that do not share characteristics shall not be aggregated (see paragraph 27); and

(c) *aggregation and disaggregation in the financial statements shall not obscure relevant information or reduce the understandability of the information presented or disclosed.*

26 When presenting information in the primary financial statements or disclosing information in the notes, the description of the items shall faithfully represent the characteristics of those items.

27 An entity may aggregate immaterial items that do not share characteristics. However, using a non-descriptive label such as 'other' to describe a group of such items would not faithfully represent those items without additional information. Except as described in paragraph 28, to faithfully represent aggregated items, an entity shall either:

(a) aggregate immaterial items with other items that share similar characteristics and can be described in a manner that faithfully represents the characteristics of the aggregated items; or

(b) aggregate immaterial items with other items that do not share similar characteristics but which may be described in a way that faithfully represents the dissimilar items.

28 If the steps set out in paragraphs 27(a)–27(b) do not lead to descriptions that result in a faithful representation, an entity shall disclose in the notes information about the composition of the aggregated items, for example, by indicating that an aggregated item consists of several unrelated immaterial amounts and by indicating the nature and amount of the largest item in the aggregation.

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Unusual income and expenses

100 ***Unusual income and expenses*** **are income and expenses with limited predictive value. Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods.**

101 **An entity shall, in a single note that includes all unusual income and expenses, disclose (see paragraphs B67–B75):**

(a) **the amount of each item of unusual income or expense recognised in the reporting period; and**

(b) **a narrative description of the transactions or other events that gave rise to that item and why income or expenses that are similar in type and amount are not expected to arise for several future annual financial reporting periods;**

(c) **the line item(s) in the statement(s) of financial performance in which each item of unusual income or expense is included; and**

(d) **an analysis of the included expenses using the nature of expense method, when an entity presents an analysis of expenses in the statement of profit or loss using the function of expense method.**

102 Income and expenses from the recurring remeasurement of items measured at a current value are expected to change from period to period. They would not normally be classified as unusual income and expenses (see paragraph B72).

…

Unusual income and expenses

B67 Paragraph 101 requires an entity to disclose information in the notes about unusual income and unusual expenses. An entity classifies income and expenses as unusual if and only if they have limited predictive value. Hence, income and expenses cannot be classified as unusual if it is reasonable to expect that income or expenses similar in type and amount will arise in any of several future annual reporting periods.

B68 In determining whether income or expenses are unusual, an entity shall consider both the type of the income or expense and its amount. For example, an impairment loss resulting from a fire at an entity's factory is normally an unusual type of expense and hence would be classified as an unusual expense because in the absence of other indicators of impairment another similar expense would not reasonably be expected to recur for several future annual reporting periods.

B69 Income and expenses that are not unusual by type may be unusual in amount. Whether an item of income or expense is unusual in amount is determined by the range of outcomes reasonably expected to arise for that income or expense in several future annual reporting periods. For example, an entity that incurs regular litigation costs that are all of a similar amount would not generally classify those litigation expenses as unusual. However, if in one reporting period, that entity incurred higher litigation costs than reasonably expected, because of a particular action, it would classify the costs from that action as unusual if litigation costs in several future annual reporting periods were not expected to be of a similar amount. The higher litigation costs are outside the range of reasonably expected outcomes and not predictive of future litigation costs.

B70 Income or expenses are classified as unusual based on expectations about the future rather than past occurrences. Hence, it is possible for income or expenses similar to income or expenses reported in previous reporting period(s) to be classified as unusual. For example, an entity may incur an impairment loss resulting from a fire at one of its factories in one period. At the end of that period, the entity classifies the impairment as an unusual expense because it has a reasonable expectation that it will not suffer an impairment loss for several future annual reporting periods. In the next period, the entity once again incurs an impairment loss resulting from a fire at another one of its factories. If the two fires in close succession are not indicative of a developing pattern of fires and impairments, it may be possible for the entity to have a reasonable expectation at the end of the second reporting period that similar expenses will not arise for several future annual reporting periods. If this is the case, the second impairment is also classified as unusual.

B71 Expectations about the future will depend on the facts and circumstances of an entity. For example, an entity that undertakes a restructuring programme spanning several reporting periods or that makes regular acquisitions that result in restructuring expenses would not classify these expenses as unusual. However, an entity that undertakes a restructuring programme and that does not expect to incur expenses of a similar type and amount in the next several reporting periods would classify these expenses as unusual.

B72 Income and expenses from the recurring remeasurement of items measured at current value would not normally be classified as unusual. Income and expenses from the remeasurement of such items are expected each reporting period and are expected to vary from period to period.

B73 When an entity identifies unusual income or expenses it does not classify related income or expenses as unusual unless those related income and expenses are themselves unusual. For example, an entity may identify a sale that gives rise to unusual revenue. In earning that revenue, the entity may incur several related costs, including employee benefit expense, inventory cost and taxes. An entity would only identify as unusual those related costs that meet the definition of unusual.

B74 When an entity discloses comparative information about unusual income and expenses it shall only classify amounts that met the definition of unusual income and expenses in the comparative period as unusual income and expenses

B75 An entity's management performance measure(s) may include some, or all, of its unusual income and expenses. In such cases, the entity may disclose the required information about those unusual income and expenses in the same note that it uses to disclose information about management performance measures provided the entity either:

(a) includes in that note all of the information required by paragraph 101 for unusual income and expenses; or

(b) provides a separate note that includes all of the information required for unusual income and expenses.

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Appendix 2

Comparison of FMA's Guidance on presenting non-GAAP financial information with IASB's proposals for disclosure of information on MPMs

<table>
<tr><td colspan="2">FMA's Guidance on presenting non-GAAP information
https://www.fma.govt.nz/assets/Guidance/120901-guidance-note-disclosing-non-gaap-financial-information.pdf</td><td colspan="2">IASB Proposals for disclosure of information on MPMs
An entity shall disclose information about any MPMs, if any, in a <u>single note</u> to the financial statements (emphasis added). (paragraph 106 and B82)</td></tr>
<tr><td>Principle</td><td>Explanation</td><td>Requirement (include paragraph numbers)</td><td>Staff notes</td></tr>
<tr><td>Defining the non-GAAP financial information</td><td>Definition
Entities should define non-GAAP financial information and support it with a clear explanation of the basis of calculation.</td><td>(a) a description of why the MPM communicates management's view of performance including an explanation of:
(i) how the MPM is calculated; and
(ii) how the measure provides useful information about the entity's performance;
(Paragraph 106(a))
Paragraph 106(a)(i) requires an explanation of how a MPM is calculated. To comply with this requirement an entity shall explain the specific principles, bases, conventions, rules and practices it applies in calculating its MPMs.
(Paragraph B84)</td><td>Requirements are essentially the same.
The IASB are defining MPMs. The proposed definition of MPMs is shown below.
MPMs are subtotals of income and expenses that (see paragraphs B76–B81):
(a) are used in public communications outside financial statements;
(b) complement totals or subtotals specified by IFRS Standards; and
(c) communicate to users of financial statements management's view of an aspect of an entity's financial performance.
(Paragraph 103)</td></tr>
<tr><td></td><td>Clear labeling
Entities should clearly label non-GAAP financial information in a way that distinguishes it from GAAP financial information.
The term or label should accurately describe and reflect the non-GAAP financial information. For example, it</td><td>MPMs shall:
(a) faithfully represent aspects of the financial performance of the entity to users of financial statements; and
(b) be described in a clear and understandable manner that does not mislead users
(Paragraph 105)</td><td>By definition an MPM is not a total or subtotal specified by IFRS Standards (therefore it is a non-GAAP measure).
The FMA guidance goes into more detail about the term or label used.
Requirements are essentially the same.</td></tr>
</table>

FMA's Guidance on presenting non-GAAP information https://www.fma.govt.nz/assets/Guidance/120901-guidance-note-disclosing-non-gaap-financial-information.pdf		**IASB Proposals for disclosure of information on MPMs** An entity shall disclose information about any MPMs, if any, in a **single note** to the financial statements (emphasis added). (paragraph 106 and B82)	
Principle	**Explanation**	**Requirement** *(include paragraph numbers)*	**Staff notes**
	is not appropriate to label a measure as EBITDA if it excludes items which are not interest, tax, depreciation or amortisation. The term or label should not cause confusion with GAAP information.		
	Use of non-GAAP financial information Entities should clearly explain the reasons for presenting the non-GAAP financial information, including: • why the information is useful to investors • how it is used internally by management[9] .	(a) a description of why the MPM communicates management's view of performance including an explanation of: (i) how the MPM is calculated; and (ii) how the measure provides useful information about the entity's performance; *(Paragraph 106(a))* In some cases, one or more of an entity's MPMs may be the same as part of the operating segment information disclosed by the entity in applying IFRS 8. In such cases, the entity may disclose the required information about those MPMs in the same note that it uses to disclose information about its operating segments provided the entity either:	Requirements are essentially the same. The FMA does require a description of how the measure is used internally by management.

[9] Note for for-profit FMC reporting entities: NZ IFRS 8 *Operating Segments* (NZ IFRS 8) requires disclosure of profit or loss for segments based on the measure reported internally to management. This may be different to the profit calculated in accordance with statutory financial reporting requirements. In most cases, we expect that any non-GAAP profit information disclosed will not differ from the segment reporting disclosures in the financial statements. If non-GAAP profit information is disclosed and it differs from the segment reporting disclosures in the financial statements, an explanation should be included justifying this difference. No explanation is required if the differences comprise only normal inter-segment eliminations or corporate expense allocations.

FMA's Guidance on presenting non-GAAP information https://www.fma.govt.nz/assets/Guidance/120901-guidance-note-disclosing-non-gaap-financial-information.pdf		**IASB Proposals for disclosure of information on MPMs** An entity shall disclose information about any MPMs, if any, in a **single note** to the financial statements (emphasis added). (paragraph 106 and B82)	
Principle	**Explanation**	**Requirement** *(include paragraph numbers)*	**Staff notes**
		(a) includes in that note all of the information required by paragraph 106 for MPMs; or (b) provides a separate note that includes all of the information required for MPMS. *(Paragraph B83)*	
	Entities should make a statement that the non-GAAP financial information does not have a standardised meaning prescribed by GAAP and therefore may not be comparable to similar financial information presented by other entities. You should also disclose whether the non-GAAP financial information has been subject to audit or review[10] .	**An entity shall disclose information about any management performance measures in a single note to the financial statements. That note shall include a statement that the management performance measures provide management's view of an aspect of the entity's financial performance and are not necessarily comparable with measures sharing similar descriptions provided by other entities. In addition, for each management performance measure an entity shall disclose in the notes (see paragraphs B82–B85):** *(Paragraph 106)*	Requirements are essentially the same. Because the disclosure will be within the financial statements the information will be subject to audit.
Prominence	• Entities should not present non-GAAP financial information with undue and greater prominence, emphasis or authority than the	An entity shall not use columns to present management performance measures in the statement(s) of financial performance. *(Paragraph 110)*	The IASB is not prohibiting entities from presenting management performance measures as a subtotal in the statement of financial performance. But it is unlikely that

10 We do not consider non-GAAP financial information to have been subject to audit or review merely by virtue of the adjustment or component being taken from audited or reviewed financial statements.

FMA's Guidance on presenting non-GAAP information https://www.fma.govt.nz/assets/Guidance/120901-guidance-note-disclosing-non-gaap-financial-information.pdf		**IASB Proposals for disclosure of information on MPMs** An entity shall disclose information about any MPMs, if any, in a **single note** to the financial statements (emphasis added). (paragraph 106 and B82)	
Principle	**Explanation**	**Requirement** *(include paragraph numbers)*	**Staff notes**
	most directly comparable GAAP financial information. • When presenting non-GAAP financial information, entities should not in any way confuse or obscure presentation of GAAP financial information.	All information required to be disclosed about management performance measures **shall be included in a single note**. (paragraph B82) When an entity presents additional subtotals in accordance with paragraph 42, those subtotals shall: (a) comprise line items made up of amounts recognised and measured in accordance with IFRS Standards; (b) be presented and labelled in a manner that faithfully represents the line items that constitute the subtotal, making the subtotal clear and understandable; (c) be consistent from period to period, in accordance with paragraph 33; and (d) not be displayed with more prominence than the subtotals and totals required by IFRS Standards. *(Paragraph 43)*	many MPMs will meet the requirements to be presented in the statement of financial performance. If they do then the requirements in paragraph 43 will apply an any subtotal can not be displayed with more prominence than the subtotal required by IFRS Standards. The IASB is prohibiting entities from using columns to present an MPM in the statement(s) of financial performance. This further restricts the circumstances in which such measures may be presented in the statement(s) of financial performance helping to address the concerns of some stakeholders that doing so would give these measures undue prominence.
Reconciliation	• Entities should provide a reconciliation from the non-GAAP financial information to the most directly comparable GAAP financial information[11].	(b) a reconciliation between the management performance measure and the most directly comparable subtotal or total included in paragraph 104; *(Paragraph 106(b))*	Requirements are essentially the same.

[11] An entity may disclose a reconciliation in each document where non-GAAP financial information is disclosed, or, make a direct reference to where this information is available. If an entity provides the reconciliation by reference, the reconciliation must be easily and readily accessible.

<table>
<tr><td colspan="2">FMA's Guidance on presenting non-GAAP information
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<tr><td></td><td>• Entities should itemise and explain each significant adjustment separately.</td><td>(c) the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation required by paragraph 106(b); and
(d) how the entity determined the income tax effect required by paragraph 106(c).
An entity shall determine the income tax effect required by paragraph 106(c) on the basis of a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction(s) concerned or by another method that achieves a more appropriate allocation in the circumstances.
(Paragraph 107)</td><td>The IASB noted that MPMs disclosed in the notes to the financial statements would need to comply with the general requirements for information included in financial statements. That is:
(a) the MPM must faithfully represent the aspect of financial performance of the entity it purports to represent;
(b) the disclosures supporting the MPM must comply with the proposed guidance on aggregation and disaggregation, for example, when disclosing reconciling items;
(c) comparative information should be provided for the MPM and related disclosures; and
(d) the MPM should be calculated consistently from one period to the next and be subject to change only if the new measure provides more useful information.
(Paragraph BC158)</td></tr>
<tr><td></td><td>• If reconciling items that are components of GAAP financial information, entities should identify them in the financial statements.</td><td></td><td>If the reconciling item is an unusual income and expense item then you are required to disclose the line item in the statement of financial performance in which each item of unusual income or expense is included.</td></tr>
</table>

FMA's Guidance on presenting non-GAAP information https://www.fma.govt.nz/assets/Guidance/120901-guidance-note-disclosing-non-gaap-financial-information.pdf		**IASB Proposals for disclosure of information on MPMs** An entity shall disclose information about any MPMs, if any, in a **single note** to the financial statements (emphasis added). (paragraph 106 and B82)	
Principle	**Explanation**	**Requirement** *(include paragraph numbers)*	**Staff notes**
	• If you cannot extract a reconciling item directly from the financial statements, you should show how the number is calculated in the accompanying notes.		No similar IASB requirement.
	• If presenting comparative non-GAAP financial information for a previous period, entities should provide reconciliation to the corresponding GAAP financial information for that previous period.		The IASB noted that MPMs disclosed in the notes to the financial statements would need to comply with the general requirements for information included in financial statements. That is: (a) the MPM must faithfully represent the aspect of financial performance of the entity it purports to represent; (b) the disclosures supporting the MPM must comply with the proposed guidance on aggregation and disaggregation, for example, when disclosing reconciling items; (c) comparative information should be provided for the MPM and related disclosures; and (d) the MPM should be calculated consistently from one period to the next and be subject to change only if the new measure provides more useful information. *(Paragraph BC158)*

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<tr><td>Principle</td><td>Explanation</td><td>Requirement (include paragraph numbers)</td><td>Staff notes</td></tr>
<tr><td>Consistency</td><td>• If an entity chooses to present non-GAAP financial information, a consistent approach should be adopted from period to period.</td><td></td><td>The IASB noted that MPMs disclosed in the notes to the financial statements would need to comply with the general requirements for information included in financial statements. That is:
(a) the MPM must faithfully represent the aspect of financial performance of the entity it purports to represent;
(b) the disclosures supporting the MPM must comply with the proposed guidance on aggregation and disaggregation, for example, when disclosing reconciling items;
(c) comparative information should be provided for the MPM and related disclosures; and
(d) the MPM should be calculated consistently from one period to the next and be subject to change only if the new measure provides more useful information.
(Paragraph BC158)</td></tr>
<tr><td></td><td>• Where presented, entities should also provide the non-GAAP financial information for comparative periods.</td><td></td><td>The IASB noted that MPMs disclosed in the notes to the financial statements would need to comply with the general requirements for information included in financial statements. That is:</td></tr>
</table>

FMA's Guidance on presenting non-GAAP information https://www.fma.govt.nz/assets/Guidance/120901-guidance-note-disclosing-non-gaap-financial-information.pdf		**IASB Proposals for disclosure of information on MPMs** An entity shall disclose information about any MPMs, if any, in a **single note** to the financial statements (emphasis added). (paragraph 106 and B82)	
Principle	**Explanation**	**Requirement** *(include paragraph numbers)*	**Staff notes**
			(a) the MPM must faithfully represent the aspect of financial performance of the entity it purports to represent; (b) the disclosures supporting the MPM must comply with the proposed guidance on aggregation and disaggregation, for example, when disclosing reconciling items; (c) comparative information should be provided for the MPM and related disclosures; and (d) the MPM should be calculated consistently from one period to the next and be subject to change only if the new measure provides more useful information. *(Paragraph BC158)*
	• If there has been a change in approach from the previous period, an explanation about the nature of the change, entities should provide the reasons for the change, and the financial impact of the change.	If an entity changes the calculation of its management performance measures, introduces a new management performance measure or removes a previously disclosed management performance measure from its financial statements, it shall: (a) disclose sufficient explanation for users of financial statements to understand the change, addition or removal and its effects;	Requirements are essentially the same. The IASB does not require the financial impact of the change.

FMA's Guidance on presenting non-GAAP information https://www.fma.govt.nz/assets/Guidance/120901-guidance-note-disclosing-non-gaap-financial-information.pdf		**IASB Proposals for disclosure of information on MPMs** An entity shall disclose information about any MPMs, if any, in a **single note** to the financial statements (emphasis added). (paragraph 106 and B82)	
Principle	**Explanation**	**Requirement** *(include paragraph numbers)*	**Staff notes**
		(b) disclose the reasons for the change, addition or removal; and (c) restate its comparative information, including in the required note disclosures, to reflect the change, addition or removal. (Paragraph 108)	
Unbiased	• Non-GAAP financial information should be unbiased. Entities should not use it to avoid presenting adverse information to the market or to over-emphasise favourable information.	Management performance measures shall: (a) faithfully represent aspects of the financial performance of the entity to users of financial statements; and (b) be described in a clear and understandable manner that does not mislead users. (Paragraph 105)	Paragraph 2.13 of New Zealand equivalent to the IASB *Conceptual Framework for Financial Reporting (*2018 *NZ Conceptual Framework)* states that a faithful representation is complete, **neutral** and free from error (emphasis added). Paragraph 2.15 then goes on to say a neutral depiction is without bias in the selection or presentation of financial information.
One-off / non-recurring items	• Entities should not describe items that have occurred in the past or are reasonably likely to occur in a future period as 'one-off' or 'nonrecurring.' For example, it may be misleading to describe items such as impairment losses and restructuring costs as 'non-recurring' or 'one-off' when they are generally of a recurring nature in many businesses and usually occur over the life of a business		The IASB is introducing proposals defining and requiring the disclosure of unusual income and expenses in financial statements. Unusual income and expenses are income and expenses with limited predictive value. Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods. *(Paragraph 100)*

FMA's Guidance on presenting non-GAAP information https://www.fma.govt.nz/assets/Guidance/120901-guidance-note-disclosing-non-gaap-financial-information.pdf		**IASB Proposals for disclosure of information on MPMs** An entity shall disclose information about any MPMs, if any, in a **single note** to the financial statements (emphasis added). (paragraph 106 and B82)	
Principle	**Explanation**	**Requirement** *(include paragraph numbers)*	**Staff notes**
	(although they may only arise every few years).		
	• No 'cherry picking' adjustments. In the case of exclusion of nonrecurring items, the exclusion should reflect all non-recurring items for the relevant period (i.e. both non-recurring charges as well as any non-recurring gains) regardless of whether they are related or not.		The IASB considered specifying that information about unusual items should be neutral but rejected this as unnecessary because neutrality applies to all items included in the financial statements.

Return to memo

NZ AUDITING AND ASSURANCE STANDARDS BOARD

XRB EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	8.1
Meeting date:	12 February 2020
Subject:	Mandate Change
Date:	22 January 2020
Prepared by:	Misha Pieters

X **Action Required**	☐ **For Information Purposes Only**

Agenda Item Objectives

To:

- Consider the new XRB mandate and confirm what "related services" means for the NZAuASB;
- Provide feedback on amendments to XRB Au1 to reflect a mandate change that enables the XRB to issue an Agreed upon procedures standard;
- Consider amendments to Explanatory Guides to reflect the mandate change.

Legislative change

1. The Regulatory Systems (Economic Development) Amendment Act 2019 has been issued, which will enable the NZAuASB to issue an agreed upon procedures standard (and other related services standards). The amended wording of Section 20 of the Financial Reporting Act 2013 is as follows:

> (2) Auditing and assurance standards may (without limitation) include—
> (a) professional and ethical standards that govern the professional conduct of audit or assurance practitioners:
> (b) standards for related services.
>
> (3) In this section,—
> **audit or assurance practitioner** means a person who is appointed or engaged to carry out audits or other assurance engagements
> **related services** means services to perform—
> (a) agreed-upon procedures; or
> (b) other non-assurance work that may ordinarily be carried out by an audit or assurance practitioner.

2. XRB Au1, issued by the XRB Board, will need to be updated to reflect this new mandate. Suggested changes are at agenda item 8.2. We seek feedback from the NZAuASB prior to taking the proposals to the XRB Board meeting in March. Changes to XRB Au1 will require the XRB to follow due process, including consultation, prior to issuing a revised standard.

3. In addition, various NZAuASB explanatory guides will also require updating. Suggested changes are at agenda item 8.3 and 8.4. There is no formal requirement to expose the changes to the explanatory guides.

4. The approach taken to updating the documents is to:

- Clarify that the term “auditing and assurance standards (including professional and ethical standards)” now also include standards for related services. This expansion is only made where previously it was noted that auditing and assurance standard include professional and ethical standards;
- Clarify that the standards issued by the NZAuASB apply to assurance engagements <u>and related services;</u>
- Clarify that the NZAuASB will issue an agreed upon procedures standard and other related services standards as identified by the NZAuASB. At this stage it is not intended that the NZAuASB will issue the compilation standard, even though the IAASB’s Related Services Standard includes Compilations.
- Prepare an exposure draft of an agreed upon procedures standard based on the IAASB’s revised standard, approved in December 2019 and expected to be released in March 2020. Staff will apply the NZAuASB’s compelling reason test to this process. The same naming convention will apply (International Standard on Related Services (New Zealand)).
- Remove the explanatory guides from XRB Au 1 as these are not standards and have no legal status.

<u>Matters arising</u>

5. The following matters have been identified for discussion by the Board:

- The diagrammatic illustration of the engagements covered by the NZAuASB’ standards as updated in XRB Au1 in Appendix 6.
- Definitions:
    i. We seek feedback on the definition of assurance practitioner and whether this should be updated to reflect that the assurance practitioner can be appointed to perform related services. The legislation does not refer to other related services in the definition of assurance practitioner. While the NZAuASB’s mandate relates to services provided by the assurance practitioner, when issued the agreed upon procedures standard could also be applied by other practitioners. It may therefore not be necessary to refer to an assurance practitioner in the agreed upon procedures standard.

    ii. Whether and how to define related services. XRB Au1 could match the definition in law or could be clearer as to what other services these include when such services are identified by the Board. The Board is asked for views about what non-assurance work is expected to be captured and whether or how this should be clarified in XRB Au1.
- There will be a transition period until the NZAuASB conducts its due process and issues related services standards. We have suggested that we adopt a joint communication plan with CAANZ in the transition period, to highlight that practitioners should continue to use

the standards issued by CAANZ until such time as the NZAuASB has issued its own standards.

- We note that PES 3 on Quality Control will need to be extended to apply to Related Services, whereas previously the NAuASB has restricted the scope to assurance engagements. We note that ISQM 1 is expected to be approved in June 2020 by the IAASB. We recommend that during the transition period, the quality control standard issued by CAANZ continue to apply to related services and that PES 3 remain as is until such time as the revised ISQM 1 is adopted in New Zealand. The scope of the revised ISQM 1 will be considered by the NZAuASB once the scope of ISQM 1 is confirmed by the IAASB. The IAASB's quality control standards will apply to compilation engagements and therefore it may still be required that the NZAuASB's standard be amended in scope to exclude compilation engagements.

Material Presented

Agenda item 8.1	Board Meeting Summary Paper
Agenda item 8.2	XRB Au1 *Application of Auditing and Assurance Standards*
Agenda item 8.3	EG Au 1 *Overview of Auditing and Assurance Standards*
Agenda item 8.4	EG Au2 Overview of the Auditing and Assurance Standard Setting Process

XRB Au1
Issued ~~12~~xx/~~12~~20
~~Compiled 08/19~~

EXTERNAL REPORTING BOARD STANDARD Au1

Application of Auditing and Assurance Standards

This compilation was prepared in [date]~~August 2019 and incorporates amendments up to and including February 2019.~~

~~Effective for assurance engagements beginning on or after 1 January 2013.~~

This Standard was i~~I~~ssued on [date] by the External Reporting Board pursuant to section ~~24(1)(b~~12(a) of the Financial Reporting Act ~~1993~~2013.

This Standard is a disallowable instrument for ~~Regulation for~~ the purposes of the ~~Regulations (Disallowance)~~Legislation Act ~~1989~~2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on [date].

In finalising this Standard, the External Reporting Board has carried out appropriate consultation in accordance with section 22(1) or the Financial Reporting Act 2013.

This Standard has been issued to reflect amendments made to the Financial Reporting Act 2013, to include standards for related services within the mandate of the External Reporting Board.

This Standard, when effective, will supersede XRB Au1 *Application of Auditing and Assurance Standards*.

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EXTERNAL REPORTING BOARD STANDARD Au1

APPLICATION OF AUDITING AND ASSURANCE STANDARDS

Issued by the External Reporting Board

CONTENTS

HISTORY OF AMENDMENTS

Table of Pronouncements – XRB Au1 *Application of Auditing and Assurance Standards*

This table lists the pronouncements establishing and amending XRB Au1. This table is based on amendments approved as at December 2012.

Pronouncements	Date approved	Effective date
External Reporting Board Standard Au1 *Application of Auditing and Assurance Standards*	Dec 2012	Assurance engagements beginning on or after 1 January 2013.
Issue ISAE (NZ) 3410 *Assurance Engagements on Greenhouse Gas Statements*	December 2012	Assurance reports covering periods ending on or after September 30, 2013.
Professional and Ethical Standard 3 (Amended)	Jan 2013	Effective on 1 January 2014
Professional and Ethical Standard 1 (Revised)	Jan 2013	Effective on 1 January 2014
Issue ISRE (NZ) 2400 *Review of Historical Financial Statements Performed by an Assurance Practitioner who is Not the Auditor of the Entity*	Dec 2013	Reviews of financial statements for periods ending on or after 31 December 2014
Issue NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*	Dec 2013	Reviews of financial statements for periods ending on or after 31 December 2014
ISAE (NZ) 3000 (Revised) A*ssurance Engagements other than Audits or Reviews of Historical Financial Information*	August 2014	Effective for assurance engagements beginning on or after 1 January 2015
SAE 3150 *Assurance Engagements on Controls*	July 2015	Effective for assurance engagements beginning on or after 1 January 2016
Conforming amendments to ISAs (NZ) and other pronouncements (Auditor Reporting)	September 2015	Effective for audits of financial statements for periods ending on or after 15 December 2016
International Standards on Auditing (New Zealand) 800, 805 and 810	September 2016	Effective for audits of financial statements for periods ending on or after 15 December 2016
Conforming Amendments to ISAs (NZ) and Other Pronouncements (NOCLAR)	October 2016	Effective for audits of financial statements for periods ending on or after 15 December 2017
Conforming and Consequential Amendments to ISAs (NZ) and Other Pronouncements (Auditing Estimates)	October 2018	Effective for audits of financial statements for periods beginning on or after 15 December 2018

Pronouncements	Date approved	Effective date
NZ AS 1 *The Audit of Service Performance Information*	Feb 2019	Effective for audits of general purpose financial reports for periods beginning on or after 2021

Table of Amended Paragraphs in XRB Au1		
Paragraph affected	**How affected**	**By…[date]**
Appendix 4	Amended	Inclusion of ISAE (NZ) 3410 *Assurance Engagements on Greenhouse Gas Statements* [December 2012]
Appendix 1	Amended	Professional and Ethical Standard 3 (Amended) [Jan 2013]
Appendix 1	Amended	Professional and Ethical Standard 1 (Revised) [Jan 2013]
Appendix 3	Amended	Issue of ISRE (NZ) 2400 and NZ SRE 2410 [Dec 2013]
Appendix 4	Amended	ISAE (NZ) 3000 (Revised) [Aug 2014]
Appendix 4	Amended	Inclusion of SAE 3150 *Assurance on Engagements on Controls* [July 2015]
Appendix 2	Amended	Conforming amendments to ISAs (NZ) and other pronouncements (Auditor Reporting) [Sept 2015]
Appendix 2	Amended	International Standards on Auditing (New Zealand) 800, 805 and 810 [Sept 2016]
Appendix 2	Amended	Conforming amendments to ISAs (NZ) and other pronouncements (NOCLAR) [Oct 2016]
Appendix 2	Amended	Conforming and Consequential Amendments to ISAs (NZ) and Other Pronouncements (Auditing Estimates) [Oct 2018]
Appendix 2A	Added	NZ AS 1 *The Audit of Service Performance Information [Feb 2019]*
Appendix 6	Amended	NZ AS 1 *The Audit of Service Performance Information [Feb 2019]*

Introduction

Reasons for issuing the Standard

IN 1 This Standard codifies the standards that assurance practitioners are to apply when conducting an assurance engagement or related services in accordance with standards issued by the External Reporting Board or the New Zealand Auditing and Assurance Standards Board.

IN 2 The appendices to this Standard list the auditing and assurance, or related services, standards applicable to different ~~assurance~~ engagements.

Objective

1. The objective of this Standard is to codify the standards that assurance practitioners are to apply when conducting an assurance engagement or related services in accordance with standards issued by the External Reporting Board or the New Zealand Auditing and Assurance Standards Board.

Scope

2. This Standard identifies the auditing and assurance standards that shall be applied when conducting different types of assurance engagements or related services in accordance with standards issued by the External Reporting Board or the New Zealand Auditing and Assurance Standards Board.

3. Standards issued by the External Reporting Board or the New Zealand Auditing and Assurance Standards Board may be applied by an assurance practitioner even if there is no statutory requirement to do so. Even when applied voluntarily, all of the applicable standards should be applied to ensure that the assurance engagement or related service is of appropriate quality.

Definitions

4. For the purposes of this Standard the following term has the meaning attributed below:

   (a) Assurance Practitioner – a person or an organisation, whether in public practice, industry, commerce or the public sector, appointed or engaged to undertake assurance engagements or related services.

   (b) Related services – services to perform agreed-upon procedures.

Application of Standards

5. Assurance practitioners shall apply the professional and ethical standards listed in Appendix 1 in preparing for and conducting all assurance engagements or related services.

6. Assurance practitioners shall apply International Standards on Auditing (New Zealand) listed in Appendix 2 in conducting audits of historical financial information.

7. Assurance practitioners shall apply Review Engagement Standards listed in Appendix 3 in conducting review engagements.

8. Assurance practitioners shall apply Other Assurance Engagement Standards listed in Appendix 4 in conducting other assurance engagements.

9. Assurance practitioners shall apply Related Services Standards listed in Appendix 5 in conducting agreed upon procedures to information and other related services engagements as specified by the New Zealand Auditing and Assurance Standards Board.~~Audit Guidance Statements and International Auditing Practice Notes (New Zealand) listed in Appendix 5 are for the guidance of assurance practitioners in relevant circumstances but have no legal status. This non-authoritative material does not impose additional requirements on auditors beyond those included in the International Standards on Auditing (New Zealand), nor do they change the auditor's responsibility to comply with all International Standards on Auditing (New Zealand) relevant to the audit. They provide practical assistance to auditors. Depending on the nature of the~~

Commented [MP1]: In law, audit or assurance practitioner means a person who is appointed or engaged to carry out audits or other assurance engagements

Commented [MP2]: Consider the need for a definition of related services to clarify where the Board intends to issue standards? This is an EG so can be updated if the Board identifies additional related services to cover. Or is it better to use approach adopted in para 9?

A new definition has been added into the Financial Reporting Act section 20. The definition in law differs from the IASB definition. IAASB defines related services as "Comprise agreed-upon procedures and compilations".

In law "**related services** means services to perform—
(a)
agreed-upon procedures; or
(b)
other non-assurance work that may ordinarily be carried out by an audit or assurance practitioner.

Commented [MP3]: Suggest remove reference to guidance statements as they have no legal status. There is also inconsistency as the EGs have not been listed here.

~~topic(s) covered they may assist the auditor in:~~

~~Obtaining an understanding of the circumstances of the entity, and in making judgements about the identification and assessment of risks of material misstatement;~~

~~Making judgements about how to respond to assessed risks, including judgements about procedures that may be appropriate in the circumstances; or~~

~~Addressing reporting considerations, including forming an opinion on the financial statements and communicating with those charged with governance.~~

10. A diagrammatic overview of the auditing and assurance standards and the engagements governed by the standards is included in Appendix 6.

Effective Date

11. This Standard is effective for assurance engagements or related services beginning on or after {TBC}~~1 January 2013~~.

Appendix 1

Professional and Ethical Standards

This appendix is an integral part of the Standard.

This appendix lists the Professional and Ethical Standards to be applied in preparing for and conducting all assurance engagements or related services.

PES 1 ~~(Revised)~~	International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)
PES 3 (Amended)	Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements

Appendix 2

International Standards on Auditing (New Zealand)

This appendix is an integral part of the Standard.

This appendix lists the International Standards on Auditing (New Zealand) to be applied in conducting audits of historical financial information.

ISA (NZ) 200	Overall Objective of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)
ISA (NZ) 210	Agreeing the Terms of Audit Engagements
ISA (NZ) 220	Quality Control for an Audit of Financial Statements
ISA (NZ) 230	Audit Documentation
ISA (NZ) 240	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
ISA (NZ) 250 (Revised)	Consideration of Laws and Regulations in an Audit of Financial Statements
ISA (NZ) 260 (Revised)	Communication with Those Charged with Governance
ISA (NZ) 265	Communicating Deficiencies in Internal Control to those Charged with Governance and Management
ISA (NZ) 300	Planning an Audit of Financial Statements
ISA (NZ) 315 (Revised)	Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment
ISA (NZ) 320	Materiality in Planning and Performing an Audit
ISA (NZ) 330	The Auditor's Responses to Assessed Risks
ISA (NZ) 402	Audit Considerations Relating to an Entity Using a Service Organisation
ISA (NZ) 450	Evaluation of Misstatements Identified During the Audit
ISA (NZ) 500	Audit Evidence
ISA (NZ) 501	Audit Evidence – Specific Considerations for Selected Items
ISA (NZ) 505	External Confirmations
ISA (NZ) 510	Initial Audit Engagements – Opening Balances
ISA (NZ) 520	Analytical Procedures
ISA (NZ) 530	Audit Sampling
ISA (NZ) 540 (Revised)	Auditing Accounting Estimates and Related Disclosures
ISA (NZ) 550	Related Parties
ISA (NZ) 560	Subsequent events
ISA (NZ) 570 (Revised)	Going Concern

ISA (NZ) 580	Written Representations
ISA (NZ) 600	Special Considerations – Audits of Group Financial Statements (including the Work of Component Auditors)
ISA (NZ) 610 (Revised 2013)	Using the Work of Internal Auditors
ISA (NZ) 620	Using the Work of an Auditor's Expert
ISA (NZ) 700 (Revised)	Forming an Opinion and Reporting on Financial Statements
ISA (NZ) 701	Communicating Key Audit Matters in the Independent Auditor's Report
ISA (NZ) 705 (Revised)	Modifications to the Opinion in the Independent Auditor's Report
ISA (NZ) 706 (Revised)	Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report
ISA (NZ) 710	Comparative Information – Corresponding Figures and Comparative Financial Statements
ISA (NZ) 720 (Revised)	The Auditor's Responsibilities Relating to Other Information
ISA (NZ) 800 (Revised)	Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
ISA (NZ) 805 (Revised)	Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
ISA (NZ) 810 (Revised)	Engagements to Report on Summary Financial Statements

Appendix 2A

New Zealand Auditing Standards

This appendix is an integral part of the Standard

This appendix lists the New Zealand Auditing Standards to be applied in conjunction with the International Standards on Auditing (New Zealand) in conducting an audit of general purpose financial reports which comprise the financial statements and service performance information.

NZ AS 1	The Audit of Service Performance Information

Appendix 3

Review Engagement Standards

This appendix is an integral part of the Standard.

This appendix lists the Review Engagement Standards to be applied in conducting review engagements.

ISRE (NZ) 2400	Review of Historical Financial Statements Performed by an Assurance Practitioner who is Not the Auditor of the Entity
NZ SRE 2410	Review of Financial Statements Performed by the Independent Auditor of the Entity

Appendix 4

Other Assurance Engagement Standards

This appendix is an integral part of the Standard.

This appendix lists the Other Engagement Standards to be applied in conducting other assurance engagements.

ISAE (NZ) 3000 (Revised)	Assurance Engagements other than Audits or Review of Historical Financial Information
ISAE (NZ) 3402	Assurance Reports on Controls at a Service Organisation
ISAE (NZ) 3410	Assurance Engagements on Greenhouse Gas Statements
ISAE (NZ) 3420	Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus
SAE 3100 (Revised)	Compliance Engagements
SAE 3150	Assurance Engagements on Controls

Appendix 5

~~Audit Guidance Statements and International Auditing Practice Notes (New Zealand)~~Related Services Standards

This appendix is an integral part of the Standard.

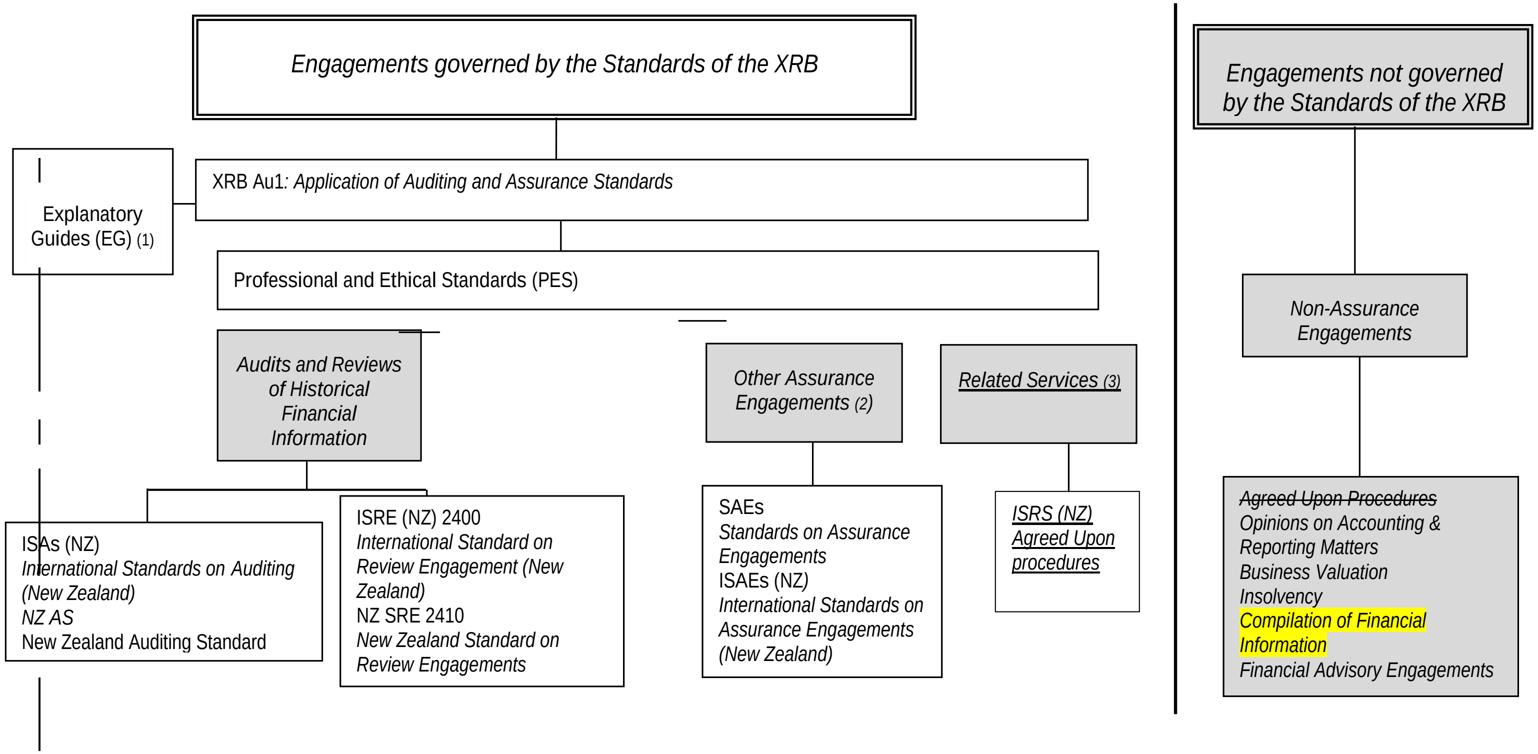
This appendix lists the Related Services Standards to be applied in conducting agreed upon procedures to information and other related services as specified by the New Zealand auditing and Assurance Standards Board.

~~This appendix lists the Audit Guidance Statements and International Auditing Practice Notes (New Zealand) for consideration by assurance practitioners in relevant circumstances. The Audit Guidance Statements and International Auditing Practice Notes provide guidance on interpreting and applying auditing standards and have no legal status. Audit Guidance Statements and International Auditing Practice Notes do not impose additional requirements on auditors beyond those included in the International Standards on Auditing (New Zealand), nor do they change the auditor's responsibility to comply with all International Standards on Auditing (New Zealand) relevant to the audit. Audit Guidance Statements and International Auditing Practice Notes provide practical assistance to auditors.~~

~~AGS-1003~~	~~Audit Issues Relating to the Electronic Presentation of Financial Reports~~
~~IAPN (NZ) 1000~~	~~Special Considerations in Auditing Financial Instruments~~

Appendix 6

Overview of the Auditing and Assurance Standards of the XRB, and the Engagements Governed by the Standards



Note (1): The Explanatory Guides are explanatory documents and have no legal status.

Note (2): The XRB’s legislative mandate is restricted to standards relating for use in assurance engagements required by statute. The Board may also issue standards relating to Other Assurance Engagements where there is no statutory requirement for assurance, provided the Minister of Commerce authorises the XRB to do so.

Note (3): The XRB’s legislative mandate includes related services, meaning services to perform agreed-upon procedures or other non-assurance work that may ordinarily be carried out by an audit or assurance practitioner.

Basis for Conclusions on XRB Au1

This Basis for Conclusions accompanies, but is not part of, XRB Au1.

Introduction

BC1 This Basis for Conclusions outlines the rationale for the requirements in this Standard.

Auditing and assurance standards

BC2 This Standard is issued to assist assurance practitioners in identifying the relevant auditing and assurance standards to be used in specific circumstances. It was issued to provide a comprehensive list of the auditing and assurance standards that are to be applied by assurance practitioners when conducting an assurance engagement or related services in accordance with standards issued by the External Reporting Board or the New Zealand Auditing and Assurance Standards Board.

EG Au1
Issued 08/11
Amended 06/14

EXPLANATORY GUIDE Au1

Overview of Auditing and Assurance Standards

This Explanatory Guide sets out the role and functions of the External Reporting Board (XRB) and its sub-Board the New Zealand Auditing and Assurance Standards Board (NZAuASB) in issuing auditing and assurance standards. It outlines the auditing and assurance standards that should be applied by assurance practitioners and the extent of their legal obligation to do so.

This Explanatory Guide is an explanatory document and has no legal status.

ISBN 978-1-927174-45-6

EXPLANATORY GUIDE Au1

OVERVIEW OF AUDITING AND ASSURANCE STANDARDS

Issued by the External Reporting Board

CONTENTS

Introduction

1 This Explanatory Guide provides an overview of auditing and assurance standards in New Zealand. It covers four main topics:

- The roles and responsibilities of the External Reporting Board (XRB Board), and its sub-Board the New Zealand Auditing and Assurance Standards Board (NZAuASB);
- The requirement to comply with auditing and assurance standards issued by the XRB;
- The auditing and assurance standards and other documents issued by the XRB, and the legal standing of those documents; and
- The auditing and assurance standards applying to different assurance engagements and related services.

2 A separate Explanatory Guide (EG Au2: *Overview of the Auditing and Assurance Standard Setting Process*) provides an overview of the process that the XRB Board expects the NZAuASB to follow in developing or adopting, and issuing auditing and assurance standards.

Roles of the XRB Board and the NZAuASB

3 The XRB is an independent Crown Entity with continued existence under section 11 of the Financial Reporting Act 2013 and subject to the provisions of the Crown Entities Act 2004. For the purposes of this Explanatory Guide the organisation as a whole is referred to as the XRB while the Board itself is referred to as the XRB Board.

4 The functions of the XRB are specified in the Financial Reporting Act 2013. In relation to auditing and assurance standards they comprise:

- Developing and issuing auditing and assurance standards (including professional and ethical standards for assurance practitioners and standards for related services) and amendments to auditing and assurance standards for application by statutory auditors or other assurance practitioners required to comply with those standards (section 12(b));
- Developing and implementing strategies for the issue of auditing and assurance standards in order to provide a framework for the XRB's overall direction in the setting of standards (section 12(d));
- Liaising with international or national organisations that have responsibility for auditing and assurance standard setting (section 12(e)); and
- Consulting with persons or organisations (or their representatives) who, in the opinion of the XRB Board, would be affected by the issue or amendment of an auditing or assurance standard (section 22).

5 While all the functions and responsibilities of the XRB ultimately rest with the XRB Board, the XRB Board has decided to delegate the responsibility for auditing and assurance standard setting to a sub-board, the NZAuASB. The NZAuASB has been established in accordance with the powers vested in the XRB Board under Schedule 5 of the Crown Entities Act 2004.

6 Accordingly, the role of the XRB Board under these arrangements is three-fold: organisational governance; financial reporting strategy setting; and appointing and monitoring the performance of the NZAuASB. The financial reporting strategy setting function (required by section 12 (d) of the Financial Reporting Act 2013) includes the establishment (and, if necessary, the revision) of the XRB assurance standards framework.

7 The NZAuASB is responsible for developing and issuing auditing and assurance standards. In doing so the NZAuASB must:

(a) Operate within the XRB assurance standards framework established by the XRB Board;

(b) Liaise with the Australian Auditing and Assurance Standards Board (AUASB) with the objective of harmonising auditing and assurance standards in Australia and New Zealand; and

(c) Ensure an appropriate consultation process (due process) is followed – see EG Au2: *Overview of the Auditing and Assurance Standard Setting Process* for an explanation of these requirements.

8 The NZAuASB operates under delegated authority from the XRB Board.

Requirement to comply with Auditing and Assurance Standards

9 Various New Zealand enactments require assurance practitioners to comply with the auditing and assurance standards issued by the XRB (including professional and ethical standards for assurance practitioners and standards for related services). For example, the Auditor Regulation Act 2011 requires all auditors of FMC reporting entities to comply with the XRB auditing and assurance standards.

10 Professional bodies may also require their members who are assurance practitioners to comply with the auditing and assurance standards issued by the XRB (including professional and ethical standards for assurance practitioners and standards for related services).

11 Other assurance practitioners may voluntarily comply with the auditing and assurance standards issued by the XRB (including professional and ethical standards for assurance practitioners and standards for related services).

Types of Documents Issued by the XRB

12 As outlined in paragraph 11, compliance with auditing and assurance standards is a legal requirement for certain assurance practitioners and in these cases the Standards have legal standing. Further, under section 35 of the Financial Reporting Act 2013, auditing and assurance standards issued under section 12(b) are classified as disallowable instruments for the purposes of the Legislation Act 2012. They are therefore legislative instruments.

13 However, not all the documents issued by the XRB have this legal status. Between them the XRB Board and the NZAuASB issue four types of documents:

(a) Auditing and assurance standards which are issued under section 12(b) of the Financial Reporting Act 2013;

(b) Guidance Statements and Practice Statements which provide guidance on interpreting and applying auditing and assurance standards, that have no legal status;

(c) Consultation documents, such as consultation papers and exposure drafts, that have no legal status; and

(d) Explanatory documents (such as this Explanatory Guide), that have no legal status.

Only the documents in paragraph 13(a) (which are issued under section 12(b) of the Financial Reporting Act 2013) have legal standing.

14 The XRB Board considers it important that the legal status of each document issued by the XRB or the NZAuASB is clear. Accordingly, its policy is to indicate on the front page of each document the legal standing of that document.

Auditing and Assurance Standards

15 Auditing and assurance standards issued by the XRB or the NZAuASB are the primary indicators of good assurance practice in New Zealand. The standards contain objectives, definitions, requirements, application and other explanatory material, introductory material and appendices. They set out the requirements or basic principles and essential procedures that assurance practitioners should follow when conducting an assurance engagement, and the behaviours that they should display as part of, and surrounding, that work. The assurance practitioner should apply the mandatory components of the auditing and assurance standards when conducting assurance engagements. The mandatory components are included under the headings listed below:

- Effective date;
- Objective(s);
- Definition(s);
- Requirements.

16 The assurance practitioner should have an understanding of the entire text of the standard, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. The non-mandatory material is included in each standard under the headings listed below:

- Introduction(s);
- Application and Other Explanatory Material;
- Appendices.

Appendices, which form part of the application material, are an integral part of a standard. The purpose and intended use of an appendix are explained in the body of the related standards or within the title and introduction of the appendix itself. Explanatory material does not create or extend mandatory components.

Auditing and Assurance Standards Applying to Different Assurance Engagements and Related Services

17 The auditing and assurance standards comprise ~~four~~ five suites of standards:

(a) Professional and Ethical Standards;

(b) International Standards on Auditing (New Zealand) (ISAs (NZ)) and New Zealand Auditing Standards;

(c) Review Engagement Standards including International Standards on Review Engagements (New Zealand) (ISRE (NZ)) and New Zealand Standard on Review Engagements (NZ SRE); and

(d) Other Assurance Engagements Standards - Standards on Assurance Engagements (SAEs) and International Standards on Assurance Engagements (New Zealand) (ISAEs (NZ)).

~~(d)~~(e) Related Services Standards including International Standard on Related Services (New Zealand) (ISRS (NZ))

18 XRB Standard Au1 *Application of Auditing and Assurance Standards* (XRB Au1) establishes which suite of standards applies to which type of assurance engagement. In summary this is as follows:

- All assurance practitioners are required to apply the professional and ethical standards in preparing for and conducting an assurance engagement or related services.
- Assurance practitioners conducting an audit of historical financial information are required to apply International Standards on Auditing (New Zealand).
- Assurance practitioners conducting a review of historical financial information are required to apply Review Engagement Standards.
- Assurance practitioners conducting assurance engagements other than audits or reviews of historical financial information are required to apply Other Assurance Engagement Standards.
- Assurance practitioners conducting agreed upon procedures and other related services as specified by the NZAuASB are required to apply International Standard on Related Services (New Zealand).

19 The specific standards to be applied are detailed in XRB Au1.

Professional and Ethical Standards

20 There are two Professional and Ethical Standards:

- Professional and Ethical Standard 1 ~~(Revised)~~: *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*
- Professional and Ethical Standard 3 (Amended): *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements*

21 Professional and Ethical Standard 1 ~~(Revised)~~ is based on the Code of Ethics issued by the International Ethics Standards Board for Accountants (IESBA) as it applies to assurance ~~engagements~~practitioners. Professional and Ethical Standard 3 (Amended) is based on International Standard on Quality Control (ISQC) 1 issued by the International Auditing and Assurance Standards Board (IAASB).

International Standards on Auditing (New Zealand) (ISAs (NZ))

22 An audit is designed to provide a high, but not absolute, level of assurance, expressed positively in the auditor's report as reasonable assurance, that the information subject to audit is free of material misstatement.

23 International Standards on Auditing (New Zealand) (ISAs (NZ)) are based on the equivalent International Standards on Auditing issued by the IAASB. ISAs (NZ) are written in the context of an audit of financial statements[1] by an independent auditor. They are to be applied, as appropriate, to all audits.

24 ISAs (NZ) follow the format of the pronouncements issued by the IAASB. However, ISAs (NZ) cross refer to other New Zealand Standards (rather than ISAs) and state an application date as determined by the XRB or the NZAuASB.

25 ISAs (NZ) are supported by International Auditing Practice Notes (New Zealand) (IAPNs (NZ)) and Audit Guidance Statements (AGs). The IAPNs (NZ) and AGs provide guidance on the application of ISAs (NZ) but have no legal standing.

Review Engagement Standards

26 A review is a limited assurance engagement. The nature, timing and extent of procedures performed in a limited assurance engagement is limited compared with that necessary for an audit.

27 The objective of a review engagement of financial information is to enable the reviewer to express a conclusion in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the reviewer's attention to cause the reviewer to believe that the financial information is materially misstated. A review report helps lend some credibility to the financial information. The user, however, should be informed that an audit has not been performed.

28 There are currently ~~three~~ two review standards:

- ~~RS-1 *Statement of Review Engagement Standards*;~~
- ISRE (NZ) 2400 *Review of Historical Financial Statements Performed by an Assurance Practitioner*; and
- NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*

~~29 RS-1 was issued by the XRB Board on 1 July 2011 and applies to reviews of historical financial statements for periods beginning on or after 1 September 2011, and to other review engagements beginning on or after 1 September 2011. RS-1 is a domestic standard and is not directly derived from the international standard issued by the IAASB. RS-1 will be superseded by ISRE (NZ) 2400 and NZ SRE 2410 for periods ending on or after December 31, 2014. Early adoption is permitted.~~

~~30~~29 ISRE (NZ) 2400 and NZ SRE 2410 are written in the context of a review of historical financial information. Limited assurance engagements other than reviews of historical financial information are performed under ISAE (NZ) 3000.

Other Assurance Engagement Standards

~~31~~30 The Other Assurance Engagements Standards ((SAEs) and (ISAEs (NZ)) apply to assurance engagements other than those relating to audits or reviews of historical financial statements. These engagements may provide either reasonable or limited assurance, depending on the nature of the engagement. These standards are issued by the XRB and the NZAuASB in accordance with section 12(b)(iii) of the Act which allows the XRB to issue other standards for purposes approved by the Minister responsible for the XRB.

~~32~~31 The SAEs are domestic standards and are not directly derived from the international standards issued by the IAASB.

~~33~~32 The ISAEs (NZ) are based on the equivalent international standards on assurance engagements issued by the IAASB. They follow the format of the pronouncements issued by the IAASB.

[1] Unless otherwise stated, "financial statements" means financial statements comprising historical financial information.

Related Services Standards

~~34~~33 International Standards on Related Services (New Zealand) (ISRSs) are to be applied when conducting agreed upon procedures to information and other related services as specified by the NZAuASB. These engagements are not assurance engagements.

EXPLANATORY GUIDE Au2

Overview of the Auditing and Assurance Standard Setting Process

Issued August 2014

This Explanatory Guide outlines the due process that is followed by the New Zealand Auditing and Assurance Standards Board (NZAuASB), a sub-Board of the External Reporting Board (XRB), in developing and issuing auditing and assurance standards.

This Explanatory Guide is an explanatory document and has no legal status.

ISBN 978-1-927292-65-5

EXPLANATORY GUIDE Au2

OVERVIEW OF THE AUDITING AND ASSURANCE STANDARD SETTING PROCESS

Issued by the External Reporting Board

CONTENTS

Introduction

1. The External Reporting Board (XRB) is an independent Crown Entity with continued existence under section 11 of the Financial Reporting Act 2013, and is subject to the provisions of the Crown Entities Act 2004. The XRB is responsible for:
   (a) developing a financial reporting strategy;
   (b) developing and issuing accounting standards and authoritative notices[1];
   (c) developing and issuing auditing and assurance standards (including professional and ethical standards and standards for related services);
   (d) liaising with similar international or national organisations.
2. In this Explanatory Guide the organisation is referred to as the XRB and the governance group is referred to as the XRB Board.

Roles of the XRB and the NZAuASB

3. The XRB Board has established a sub-board, the New Zealand Auditing and Assurance Standards Board (NZAuASB). The NZAuASB is responsible for developing and issuing auditing and assurance standards. The NZAuASB operates under delegated authority from the XRB Board.
4. Although responsibility for setting auditing and assurance standards has been delegated to the NZAuASB, the XRB Board is responsible for ensuring that appropriate due process occurs in the promulgation of standards. Due process is an essential part of an effective standard setting process, and is also a statutory obligation. The XRB Board considers due process to be important to achieving the XRB's outcome goal of *the*

[1] Under section 12 (c) of the Financial Reporting Act 2013, "authoritative notices" may be issued by the XRB Board for the purposes of the definition of generally accepted accounting practice.

establishment of an accounting and assurance standards that engender confidence in New Zealand financial reporting, assist entities to compete internationally and enhance entities' accountability to stakeholders.

5. The XRB Board has established a minimum set of due process requirements to be followed by the NZAuASB in carrying out its responsibilities. Those requirements are outlined in this Explanatory Guide. This Explanatory Guide has been published so that the standard setting process is clear and transparent to constituents and to indicate where constituents may contribute to the process.

The NZAuASB Standard Setting Process

The standard setting environment

6. In broad terms the NZAuASB issues two types of standards:

   (a) standards based on international standards developed and issued by two international standards-setting bodies, the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA) of the International Federation of Accountants (IFAC); and

   (b) domestic standards.

7. The XRB Board supports the adoption of international standards where they are applicable. The majority of current auditing and assurance standards are based on the international equivalent. Accordingly, a significant part of the work of the NZAuASB is to continue to develop New Zealand standards based on international standards, including any amendments thereto.

8. In developing New Zealand standards that are based on international standards, the NZAuASB takes into account the due process followed by the IAASB and the IESBA – these are described in *IFAC's Standards-setting Public Interest Activity Committees' Due Process and Working Procedures – March 2010*.[2]

9. In addition, the XRB Board is strongly committed to harmonising New Zealand and Australian auditing and assurance standards. This harmonisation work also impacts on the process followed in developing and adopting auditing and assurance standards.

10. The NZAuASB uses one of two different processes to develop and issue standards. The specific process applied depends on the type of standard, its source and relevant circumstances. The two processes set out in this Explanatory Guide and the standards that they relate to are summarised in the following table:

Process	Type of standard
Process 1 – Process for standards based on international standards	• International Standards on Auditing (New Zealand) (ISAs (NZ)) • International Standards on Assurance Engagements (New Zealand) (ISAEs (NZ)) • International Standards on Review Engagements (New Zealand) (ISREs (NZ)) • International Standards on Related

[2] Available at http://web.ifac.org/download/PIAC-Due_Process_and_Working_Procedures.pdf

	Services (New Zealand) • Professional and Ethical Standards (PESs)
Process 2 – Process for domestic standards	• New Zealand Standard on Auditing (NZ AS) • New Zealand Standard on Review Engagements (NZ SRE) • Standard on Assurance Engagements (SAEs)

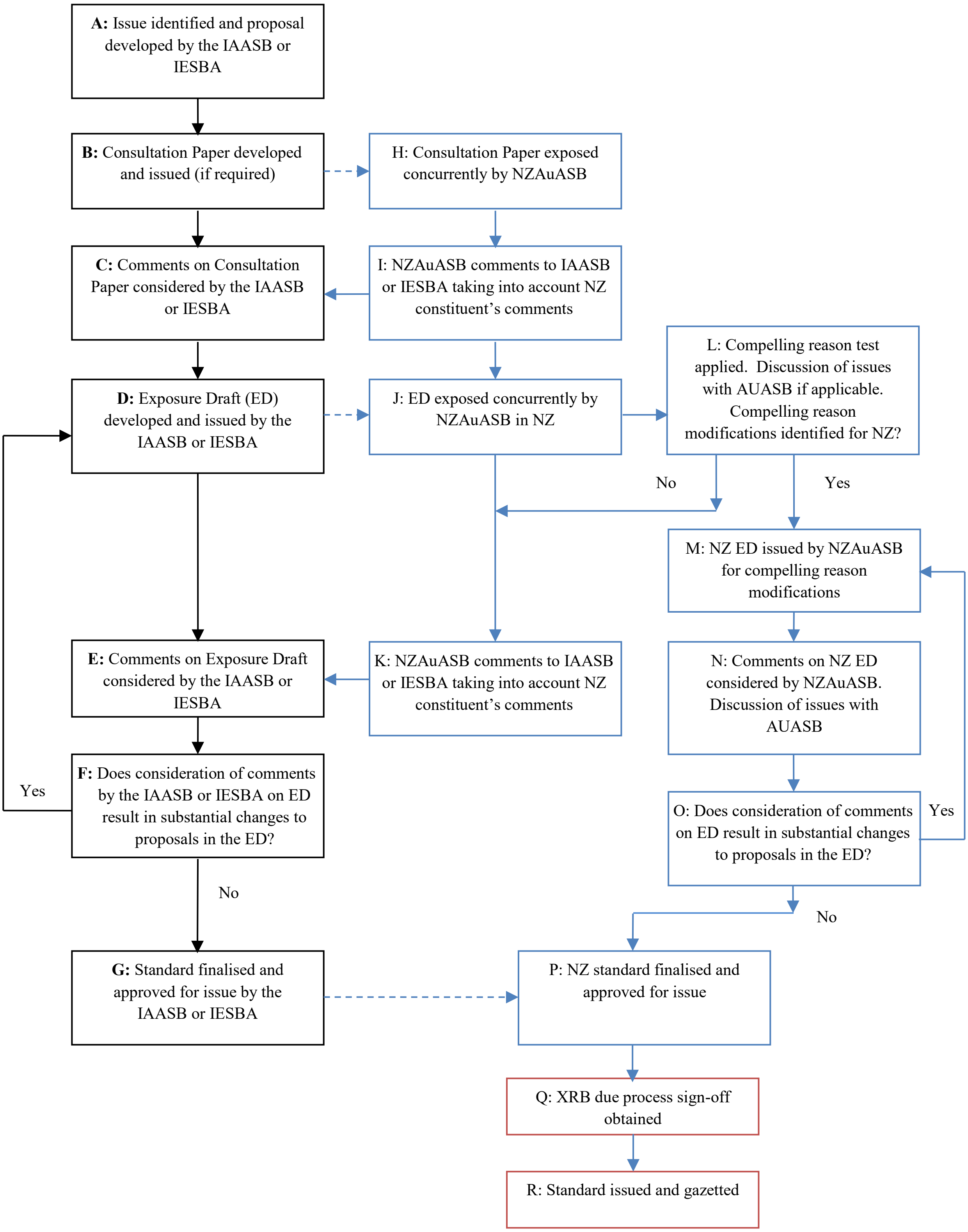
11. The NZAuASB occasionally issues other documents, such as explanatory guides. These are usually issued without formal public consultation because they contain explanatory material, have no legal status and are not mandatory.

12. In addition to the due process followed by the NZAuASB in developing and issuing standards, transparency of the NZAuASB's standard setting role is enhanced by the technical sessions of the NZAuASB meetings being open to the public. Furthermore, NZAuASB agenda papers are available on the XRB's website prior to a meeting, and minutes of meetings are available once they have been approved.

Process 1: Process for standards based on international standards

13. The process the NZAuASB follows for developing auditing and assurance standards based on international standards issued by the IAASB or IESBA is set out in Figure 1. Figure 1 should be read in conjunction with the commentary on Process 1. The steps in the commentary refer to the steps in Figure 1.

Figure 1: Process for standards based on international standards



International Due Process: Steps A-G

14. The XRB Board is committed to adopting international auditing and assurance standards. The New Zealand auditing and assurance standards are based on the international standards and are in most cases substantively identical to the international standards on which they are based. This approach is consistent with the XRB Board's strategy of adopting international standards where it is appropriate to do so. The XRB Board recognises that in doing so it is

committing to using the set of International Standards on Auditing as a whole. This means that the failure to adopt any particular standard would remove the ability of assurance practitioners in New Zealand to assert compliance with those standards.

15. The process the NZAuASB follows in developing auditing and assurance standards based on international standards issued by the IAASB or IESBA is aligned with IFAC's international due process for issuing international auditing and assurance standards. Steps A-G in Figure 1 represent IFAC's international process followed by the IAASB and the IESBA. While this international due process is a critical aspect of the overall standard setting process in New Zealand and is relied on by the NZAuASB, Process 1 focusses on the steps the NZAuASB takes when issuing auditing and assurance standards based on IAASB or IESBA standards.

16. The XRB Board and the NZAuASB consider that commenting on IAASB and IESBA documents as well as contributing to the development of those documents, where appropriate, is important to support the work of the IAASB and the IESBA and to ensure that the standard issued internationally (and subsequently adopted in New Zealand) is appropriate for New Zealand standards. International standards per se are not issued in New Zealand. Accordingly, the NZAuASB's involvement in the process of issuing international standards ceases when the exposure draft submission process is completed.

New Zealand Parallel Due Process: Steps H-K

17. When the IAASB or IESBA issues a document (such as an exposure draft or consultation paper), the NZAuASB notifies interested parties that the document has been issued and is available to comment on in New Zealand. Where appropriate, the IAASB, IESBA or the NZAuASB arranges forums to enable discussion and exchanges of opinion on the document.

18. Constituents' comments will generally be sought on:

    (a) the proposals set out in the international exposure draft or discussion document;

    (b) any regulatory issues or other factors specific to the New Zealand economic and legal environment that could affect implementation of the proposals; and

    (c) whether there are any compelling reasons for the proposals to be modified for application in New Zealand (refer to steps L-O).

19. The IAASB's international due process comment period varies depending on the complexity of the topic, but is ordinarily 120 days[3]. The IESBA's exposure period is ordinarily not shorter than 90 days. Proposed changes that result in only minor amendment to an issued international standard may be progressed more quickly.

20. Anyone can send comments to the IAASB or the IESBA on their documents. As the national standard setter, the NZAuASB sends comments to the IAASB or IESBA if it considers it appropriate to do so. Constituents can comment directly to the IAASB, IESBA or to the NZAuASB. If comments are made directly to the IAASB or IESBA, the NZAuASB appreciates receiving a copy so it can take these comments into account when developing its own comments to those Boards. Unless a constituent requests otherwise, their comments are included on the XRB's website. However, all comments the NZAuASB receives remain subject to the Official Information Act 1982 and the Privacy Act 1993.

[3] The concurrent comment period in New Zealand is usually marginally shorter to enable the NZAuASB to receive comments from New Zealand constituents before making its own submission to the IAASB or the IESBA.

New Zealand Separate Due Process: Steps L-O

21. If an international standard is adopted without substantive change in New Zealand, the NZAuASB proceeds to issue the New Zealand standard once it has been issued internationally.

22. The XRB Board recognises that the NZAuASB may consider modifying international standards for application in New Zealand where there are compelling reasons to do so. The XRB Board considers such modifications acceptable provided that they consider the public interest, and do not conflict with or result in lesser requirements than the international standards.

23. If the NZAuASB considers that modifications to an international auditing or assurance standard is required in developing it as a New Zealand standard (that is where compelling reasons modifications are identified for New Zealand), there will be a separate due process for that New Zealand modification. Ideally, the separate due process will be around the same time as the international due process, with the proposed New Zealand modifications clearly highlighted. New Zealand standards based on international standards that contain modifications from international standards will clearly identify the modification.

24. The XRB Board is also committed to harmonising New Zealand and Australian auditing and assurance standards. Australia has also adopted standards based on international standards. The AUASB has a parallel policy of convergence with international standards issued by the IAASB. The NZAuASB works with the Australian Auditing and Assurance Standards Board (AUASB) towards harmonised standards based on international standards Therefore, in most cases harmonisation will follow as the result of the respective policies of converging with international standards.

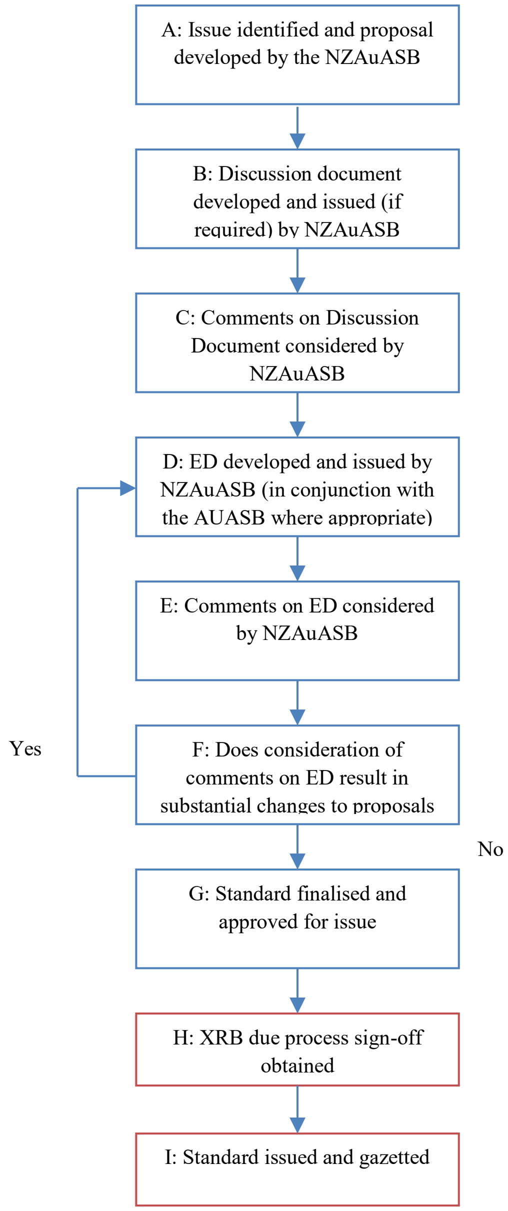
Finalisation: Steps P-R

25. Once the international standard has been issued, or the New Zealand modifications are finalised for approval, the NZAuASB finalises the New Zealand standard and approves it for issue in accordance with the XRB's approval process and with the legislative process set out in the Financial Reporting Act 2013 (see section on **XRB's approvals and legislative process**). Where appropriate, the NZAuASB may issue an "Explanation for Decisions Made" setting out the main matters raised by constituents, and the decisions made by the NZAuASB when finalising the standard.

Process 2: Process for Domestic Standards

26. The process the NZAuASB follows for developing domestic standards is set out in Figure 2. Figure 2 should be read in conjunction with the commentary on Process 2. The steps in the commentary refer to the steps in Figure 2.

Figure 2: Process for Domestic Standards



Steps A-F

27. Domestic standards may be developed to address matters specific to New Zealand, or which are important to New Zealand, but which are not addressed by international auditing and assurance standards.

28. The development of a New Zealand standard is harmonised with any equivalent Australian standard, where applicable. Differences may arise where different regulatory requirements apply or different practices are considered appropriate.

29. In developing domestic standards, constituents' views are sought on the need for, and content of, any requirements. For some projects, the NZAuASB may issue a discussion document identifying matters that the NZAuASB is considering and options for those matters.

30. For all proposed standards, the NZAuASB prepares an exposure draft and accompanying explanatory material that highlights the reason for its development.

31. Interested parties are notified of the issue of all discussion documents and exposure drafts. Where appropriate, forums are arranged or other arrangements made to enable further discussion and exchanges of opinion.

32. The comment period can vary depending on the complexity of the topic, but is typically 90 days. Shorter comment periods are used only for urgent or minor matters and will never be less than 30 days.

33. Constituents' comments will generally be sought on the proposed requirements and the need for any further additional requirements. Constituents' comments are taken into account when finalising the domestic standard. Unless a constituent requests otherwise, their comments are included on the XRB's website. However, comments the NZAuASB receives are subject to the Official Information Act 1982 and the Privacy Act 1993.

Steps G-I

34. Following the comment period, and the consideration of the comments by the NZAuASB, the NZAuASB finalises the standard and approves it for issue in accordance with the XRB's approval process and with the legislative process set out in the Financial Reporting Act 2013 (see section on **XRB's approvals and legislative process**). Where appropriate, the NZAuASB may issue an "Explanation for Decisions Made" setting out the main matters raised by constituents, and the decisions made by the NZAuASB when finalising the standard.

Process for revocations of standards

35. The process the NZAuASB follows for revoking standards is set out in Figure 3.

Figure 3: Process for revocations of standards and authoritative notices

A: Proposed revocation developed and issued by NZAuASB

↓

B: Comments on proposed revocation considered by NZAuASB

↓

C: Revocation finalised and approved for issue

↓

D: XRB due process sign-off obtained

↓

E: Revocation issued and gazetted

Steps A-B

36. The Financial Reporting Act 2013 requires that the due process applying to the issue of standards also applies to their revocation[4]. Before the NZAuASB revokes a standard, it must ensure that people or organisations likely to be affected have been adequately consulted.

[4] It should be noted that a standard may be superseded when it is replaced with another standard. A separate consultation process is not undertaken for the superseded standard as its proposed supersedence is included in the consultation process for the proposed replacement standard.

37. The NZAuASB develops and issues the proposed revocation, including the reason for the revocation. Interested parties are notified of the issue of the proposed revocation. The comment period for the proposed revocation is typically 90 days.

38. Constituents' comments are generally sought on the proposed revocation, and those comments are taken into account when finalising the revocation. Unless a constituent requests otherwise, their comments are included on the XRB's website. However, all comments the NZAuASB receives are subject to the Official Information Act 1982 and the Privacy Act 1993.

Steps C-E

39. Following the comment period, and the NZAuASB considering the comments, the NZAuASB finalises the revocation and approves it for issue in accordance with the XRB's approval process and with the legislative process set out in the Financial Reporting Act 2013 (see section on **XRB's approvals and legislative process**). Where appropriate, the NZAuASB may issue an "Explanation for Decisions Made" document setting out the main matters raised by constituents, and the decisions made by the NZAuASB when finalising the revocation.

XRB approvals and legislative process

40. Before approving a standard, amendment or revocation for issue the NZAuASB needs to satisfy itself that reasonable steps have been taken to consult with people or organisations likely to be affected by their content.

41. The NZAuASB is required[5] to obtain a certificate signed by a member of the XRB Board (usually the Chair of the XRB), authorising the issue of the standard, amendment or revocation.

42. Before signing a certificate, the member of the XRB Board checks that the standard, amendment or revocation is consistent with the XRB's financial reporting strategy, that due process has been followed, and that matters raised by constituents have been adequately considered. In the case of a standard that is based on an international standard, this includes ensuring that the applicable international due process has been followed. This reflects the XRB Board's interest in ensuring due process is followed.

43. Following the signing of the certificate the NZAuASB formally issues the standard, amendment or revocation by public notification in the Gazette[6], and sends a communiqué to interested parties.

44. In accordance with the provisions of the Financial Reporting Act 2013, all standards, amendments and revocations issued are subject to the Legislation Act 2012. This means that these standards are treated as disallowable instruments and must be presented to Parliament within 16 sitting days of the standard being gazetted[7]. Sections 42 and 43 of the Legislation Act 2012 set out the manner in which a disallowable instrument (or provisions of a disallowable instrument) may be disallowed.

45. A standard, amendment or revocation takes effect on the 28th day after the date of its public notification in the Gazette. However, any of those documents may be treated as taking effect on its notification in the Gazette if the NZAuASB considers it necessary or desirable to do so[8].

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5 As required by section 26 of the Financial Reporting Act 2013.

6 As required by section 24 of the Financial Reporting Act 2013.

7 See section 25 of the Financial Reporting Act 2013.

8 See section 27(2) of the Financial Reporting Act 2013.

46. The requirements of existing standards that are affected by a new standard, amendment or revocation remain in force until the mandatory application date of the new standard. Subject to the requirements of the standard, a new or revised or amended standard may be applied in advance of its mandatory application date.

NZ AUDITING AND ASSURANCE STANDARDS BOARD

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	9.1
Meeting date:	12 February 2020
Subject:	Amending PES 1 to Include Part 2 of the IESBA Code
Date:	21 January 2020
Prepared by:	Sharon Walker

X	**Action Required**		**For Information Purposes Only**

Agenda Item Objectives

1. The objective for this agenda item is for the Board to:

   - to CONSIDER and APPROVE as an exposure draft ED NZAuASB 2020-1, *Proposed Amendments to Professional and Ethical Standard 1*: *Part 2, Assurance Practitioners Performing Professional Activities Pursuant to Their Relationship with the Firm.*

Background

2. Part 2 of the IESBA Code sets out requirements and application material for professional accountants in business when applying the conceptual framework. Part 2 is also applicable to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm, whether as a contractor, employee or owner.

3. At the Board's December 2019 staff presented new thinking to the Board about the inclusion of Part 2 into PES 1. Current thinking is that inclusion of Part 2 of the IESBA Code, as it relates to assurance practitioners, does fit within the mandate of the NZAuASB and that it is appropriate to include it within PES 1. Accordingly, agenda item 9.3 presents proposed amendments to PES 1 to incorporate Part 2.

Matters to Consider

4. The Board is asked to CONSIDER and APPROVE NZAuASB ED 2020-1, *Proposed Amendments to PES 1: Part 2 – Assurance Practitioners Performing Professional Activities Pursuant to Their Relationship with the Firm*

Material Presented

Agenda item 9.1	Board Meeting Summary Paper
Agenda item 9.2	Issues Paper
Agenda item 9.3	Draft ITC and ED (for approval)
Agenda item 9.4	NZ Contextual changes

Issues Paper

Applicability of Part 2 of the Code

1. The mandate of the XRB is to prepare and issue auditing and assurance standards which may include (without limitation) professional and ethical standards that govern the professional conduct of a person who is appointed or engaged to carry out audits or other assurance engagements. (Refer sections 12 and 20 of the Financial Reporting Act 2013)
2. The question is whether this means professional and ethical conduct whilst carrying out audits or other assurance engagements, or the professional conduct of a person employed as an assurance practitioner, i.e., the professional conduct in dealings with the firm and for the firm.
3. Current staff thinking is that the mandate extends to the professional conduct of the assurance practitioner, not only when performing assurance engagements, but also to the conduct of the assurance practitioner as an employee of the firm.
4. This aligns with the intention of the IESBA when it revised the Code to clarify the applicability of Part 2 *Professional Accountants in Business Accountants* to professional accountants in public practice. For example, R300.5 of the IESBA Code states:

   R300.5 When dealing with an ethics issue, the professional accountant shall consider the extent in which the issue has arisen or might arise. Where an individual who is an accountant in public practice is performing professional activities pursuant to the accountant's relationship with the firm, whether as a contractor, employee or owner, the individual shall comply with the provisions in Part 2 that apply to these circumstances.
5. Our current PES 1 does not include Part 2. Rather, R300.5 was amended in PES 1 as follows:

   NZ R300.5 When dealing with an ethics issue, the assurance practitioner shall consider the context in which the issue has arisen or might arise. Where an individual who is an assurance practitioner is performing assurance services pursuant to the assurance practitioner's relationship with the firm, whether as a contractor, employee or owner, the individual shall comply *with any other ethical provisions that apply to these circumstances.*
6. As outlined above, based on our current thinking that Part 2 of the Code (as it relates to an assurance practitioner's relationship with the firm) does fall within the XRB's mandate, we recommend that Part 2 should be incorporated within PES-1.

7. Does the Board agree that Part 2 should be incorporated into PES 1?

How much of Part 2 should be incorporated into PES 1?

8. The provisions in Part 2 deal mainly with matters that are relevant to professional activities that occur internally within the employing organisation. A number of those provisions may be of less relevance to an assurance practitioner. There are also provisions in Part 2 that are duplicative of material dealt with in Part 3 of the Code. For example, both Part 2 and Part 3 deal with NOCLAR and conflicts of interest.
9. However, there may be situations where those provisions will also be relevant to assurance practitioners in their capacity as contractor, employee or owner of the organisation. For example, the provisions in Part 2 of the IESBA Code relating to preparing and presenting

information and pressure to breach the fundamental principles, which are not dealt with in other parts of the Code.

10. In developing the draft exposure draft we considered whether to:

    - Incorporate Part 2 as a whole; or
    - Exclude those provisions in Part 2 that appear to be of less relevance to an assurance practitioner.

11. A key strategic objective set by the XRB Board for the NZAuASB is to adopt auditing and assurance standards, including professional and ethical standards, in New Zealand unless there are strong reasons not to. Modifications for the application in New Zealand may be acceptable provided such modifications consider the public interest, and do not conflict with or result in lesser requirements than the international standards.

12. Excluding some of the provisions of Part 2 requires judgement in determining those that are not relevant. The staff view is that such a modification is unlikely to meet the compelling reason test.

13. Incorporating Part 2 as a whole creates duplication resulting in a longer and more complex Code than is necessary to address the issues that may be relevant to assurance practitioners pursuant to their relationship with the firm. However, we expect this to be beneficial to all assurance practitioners by providing all ethical requirements in one place.

14. PES 1 requires the assurance practitioner to comply with any other ethical provisions that apply when performing assurance services pursuant to the assurance practitioner's relationship with the firm we believe that it is appropriate to amend PES 1 to incorporate the whole of Part 2.

15. Does the Board agree with the approach to incorporate Part 2 in its entirety into PES 1?

Professional Accountants in Business

16. Part 2 is applicable to professional accountants (which includes assurance practitioners) in public practice when performing professional activities pursuant to their relationship with the firm, whether as a contractor, employee or owner. The mandate of the NZAuASB applies to assurance practitioners. Accordingly, we started by taking a narrow application of Part 2 and changed references to professional accountant to assurance practitioner throughout, as this is the defined term in PES 1. This is illustrated in agenda item 9.3.

17. Further, we are proposing to amend the title of Part 2 to make it clear that it applies to assurance practitioners when performing professional activities pursuant to their relationship with the firm.

18. However, having replaced the term professional accountant with the term "assurance practitioner" throughout Part 2, as demonstrated at agenda item 9.3, we found some of the paragraphs confusing. This is because in the context of Part 2, which relates to the

employment relationship of the professional accountant in business, not all the professional activities are relevant to assurance practitioners.

19. We consider it would be less confusing to keep the term “professional accountant” in Part 2 and to clarify upfront that the term refers to an assurance practitioner, where relevant in the context of Part 2. We do not consider using the IESBA term “professional accountant in business” is necessary given the application of PES 1 to assurance practitioners. We have no need to distinguish between professional accountants who are in business and those in public practice.

20. The following text illustrates the alternative proposed paragraph NZ 200.4, using the term professional accountant, instead of assurance practitioner.

> In this Part, where relevant, the term “professional accountant” refers to an assurance practitioner when performing professional activities pursuant to the assurance practitioner’s relationship with the assurance practitioner’s firm, whether as a contractor, employee or owner. More information on when Part 2 is applicable to assurance practitioners is set out in paragraphs R120.4, R300.5 and 300.5 A1.

21. Does the Board consider using the term assurance practitioner to replace professional accountant throughout Part 2 may be confusing? If so, does the Board agree with using the term “professional accountant”, as it is described in the paragraph above?

New Zealand specific content

22. A strategic objective of the XRB is to adopt international standards unless there is a compelling reason not to.

23. In considering whether there are any compelling reasons to amend the IESBA standard, we have considered Part 2 of the NZICA Code of Ethics published by CAANZ which includes the following NZ paragraphs:

(1) NZ210.8 A1	It is generally necessary to: (a) Disclose <u>in writing</u> the nature of the conflict of interest and how any threats created were addressed to the relevant parties, including to the appropriate levels within the employing organisation affected by a conflict; and (b) Obtain consent <u>in writing</u> from the relevant parties for the member to undertake the professional activity when safeguards are applied to address the threat.

<table>
<tr><td colspan="2">Comment: NZICA has amended the IESBA paragraph. The NZICA Code adds the words “in writing” to the IESBA guidance in Part 2. In Part 3, Paragraphs NZ R310.9.1[1] and NZ R310.9.2[2] of PES 1 differ from the IESBA Code and require disclosure and consent to be writing.</td></tr>
<tr><td>(2) NZ210.8 A4</td><td><u>The member is encouraged to document all matters set-out in this section.</u></td></tr>
<tr><td colspan="2">Comment: NZICA has added this paragraph. There is no similar guidance in the IESBA code. The NZAuASB has not added paragraphs encouraging documentation throughout other Parts of the Code.</td></tr>
<tr><td>(3) NZ220.10 A1</td><td>The member is encouraged to document:
The facts.
The accounting principles or other relevant <u>technical and</u> professional standards involved.
The communications and parties with whom mattes were discussed.
The courses of action considered.
How the member attempted to address the matter(s).</td></tr>
<tr><td>(4) NZ270.3 A3</td><td>Factors that are relevant in evaluating the level of threats created by pressure include:
The intent of the individual who is exerting the pressure and the nature and extent of the pressure.
The application of laws, regulations, and <u>technical and</u> professional standards to the circumstances.
The culture and leadership of the employing organisation including the extent to which they reflect or emphasise the importance of ethical behaviour and the expectation that employee will act ethically. For example, a corporate culture that tolerates unethical behaviour might increase the likelihood that the pressure would result in a threat to compliance with the fundamental principles.
Policies and procedures, if any, that the employing organisation has established, such as ethics or human resource policies that address pressure.</td></tr>
</table>

[1] NZ R310.9.1 Where an assurance practitioner has a conflict of interest but can apply safeguards to eliminate the threat or reduce it to an acceptable level, the assurance practitioner shall disclose, in writing, the nature of the conflict of interest and related safeguards, if any, to all clients or potential clients affected by the conflict.

[2] NZ R310.9.2 When safeguards are required to reduce the threat to an acceptable level, the assurance practitioner shall obtain, in writing, the client’s consent to the assurance practitioner performing the assurance service.

Comment: NZICA has amended these paragraphs by changing “professional standards” in the IESBA Code to “technical and professional standards.” Ordinarily the NZAuASB would change “technical and professional standards” in the IESBA Code to “standards issued by the External Reporting Board, the New Zealand Auditing and Assurance Standards Board and the New Zealand Accounting Standards Board. The words “professional standards” on their own are not a contextual change and are generally not changed.

24. The NZICA paragraphs amend application material. They do not establish additional requirements on the member.

25. We consider the NZICA modifications (1) and (2) above would not meet the compelling reason test. Modifications (3) and (4) are not consistent with contextual changes made by the NZAuASB. We recommend that these modifications not be made to Part 2 by the NZAuASB.

26. We also considered changes made by the APESB to its Code. We did not identify any that would be appropriate to include in New Zealand.

27. Does the Board agree with the recommendation not to include the NZICA modifications?

Consequential amendments

28. Incorporating Part 2 into PES 1 necessitates consequential amendments to PES 1. We have identified the following areas consequential amendments:

    - Guide to the Code – to include a description of Part 2
    - NZ Preface – to delete the reference to specific parts of the IESBA Code that have been adopted
    - Glossary – to add definitions that relate to Part 2
    - Sections 120 and 300 – to remove the New Zealand paragraphs and replace these with the IESBA text. Inclusion of Part 2 in PES 1 eliminates the need for New Zealand paragraphs relating to applicability.

29. Consequential amendments have been marked in agenda item 9.3, section C.

30. Does the Board agree with the proposed consequential amendments?

Effective date

31. We propose the revisions be effective on 15 September 2020. A limited implementation period is proposed on the basis that assurance practitioners are currently required to comply with ethical requirements to address the circumstances addressed by the inclusion of Part 2.

32. Does the Board agree that a limited implementation period is appropriate?

Agenda Item 9.3

NZ AUDITING
AND ASSURANCE
STANDARDS BOARD

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

EXPOSURE DRAFT NZAUASB 2020-1

PROPOSED AMENDMENTS TO PROFESSIONAL AND ETHICAL STANDARD 1: PART 2, ASSURANCE PRACTITIONERS PERFORMING PROFESSIONAL ACTIVITIES PURSUANT TO THEIR RELATIONSHIP WITH THE FIRM

(ED NZAUASB 2020-1)

Invitation to Comment

February 2020

Table of Contents

Information for respondents

Invitation to comment

The New Zealand Auditing and Assurance Standards Board (NZAuASB)[1] is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all responses before finalising amendments to Professional and Ethical Standard 1.

If you want to comment, please supplement your opinions with detailed comments, whether supportive of critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to provide comments only for those questions, or issues, that are relevant to you.

Comments should be submitted electronically using our 'Open for comment' page at

[insert link]

The closing date for submission is xx May 2020.

Publication of Submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part of in full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the ground under the Official Information Act 1982 for doing so (e.g., that it would be likely to unfairly prejudice the commercial position of the person providing the information).

[1] The NZAuASB is a sub-Board of the External Reporting Board (XRB Board),and is responsible for setting auditing and assurance standards.

List of Abbreviations

The following abbreviations are used in this Invitation to Comment.

NZAuASB	New Zealand Auditing and Assurance Standards Board
ED	Exposure Draft
IESBA	International Ethics Standards Board for Accountants
IESBA Code	International Code of Ethics for Professional Accountants (Including International Independence Standards)
ITC	Invitation to Comment
NOCLAR	Non-compliance with laws and regulations
PAIB	Professional Accountant in Business
PAPP	Professional Accountant in Public Practice
PES	Professional and Ethical Standard
XRB	External Reporting Board

Summary of questions for respondents

1. Do you agree with the proposal to include Part 2 of the IESBA Code in PES 1 as it relates to assurance practitioners? If not, please explain why not.
2. Do you agree with the proposed consequential amendments to PES 1? If not, please explain why not.
3. Do you agree with the proposed effective date? If not, please explain why not.

1. Introduction

1.1 Purpose of this Invitation to Comment

1. The purpose of this Invitation to Comment is to seek comments on the proposals in ED NZAuASB 2020-1 *Proposed Amendments to Professional and Ethical Standard 1: Part 2, Assurance Practitioners Performing Professional Activities Pursuant to Their Relationship with the Firm.*

1.2 Background

2. In 2018, the NZAuASB issued its revised Professional and Ethical Standard 1 *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*. In line with the XRB's strategic objective, the NZAuASB adopted the IESBA's revised and restructured *International Code of Ethics for Professional Accountants (including International Independence Standards)* excluding Part 2 *Professional Accountants in Business* as Part 2 was deemed to be outside the mandate of the XRB.

3. At the international level, questions have often been asked about whether the provisions applicable to professional accountants in business (PAIB) should also apply to professional accountants in public practice (PAPP). When finalising the revised and restructured IESBA Code, the IESBA sought to clarify the applicability, recognising that in certain circumstances the provisions for PAIBs may be relevant to PAPPs.

4. It is the intent of the IESBA that the provisions in the Code should be considered and applied in a holistic manner. It is a PAPP's responsibility to consider the context in which an ethics issue has occurred, and then consult the relevant provisions in the IESBA Code, irrespective of where those provisions are located within the IESBA Code.[2]

5. Although the provisions in Part 2 of the IESBA Code deal primarily with matters that are relevant to professional activities that occur internally within the employing organisation, there are situations where those provisions will also be relevant to a PAPP when the PAPP performs professional services for clients or to the PAPP's client relationships. For example, the provisions in Part 2 of the IESBA Code relating to preparing and presenting information and pressure to breach the

[2] IESBA Basis for Conclusions, *Revisions to Clarify the Applicability of Provisions in Part C of the Extant Code to Professional Accountants in Public Practice*

fundamental principles, which are not dealt with in other parts of the Code, should be relevant to all professional activities that PAPPs perform irrespective of whether they are internal to their firm or relate to professional services provided to their client.

6. There are, however, provisions in Part 2 that may appear to be less relevant to assurance practitioners, for example, provisions relating to NOCLAR are already dealt with extensively in Part 3 of the Code. Similarly, Part 3 of the Code also deals with conflicts of interest.

7. A key strategic objective set by the XRB Board for the NZAuASB is to adopt auditing and assurance standards, including the professional and ethical standards, in New Zealand unless there are strong reasons not to. Modifications for the application in New Zealand may be acceptable provided such modifications consider the public interest, and do not conflict with or result in lesser requirements than the international standards. In line with this, the Board determined that it is not appropriate to select individual sections of Part 2 to include in PES 1, but rather to adopt the entire Part 2.

8. PES 1 currently requires the assurance practitioner to comply with any other ethical provisions that apply when performing assurance services pursuant to the assurance practitioner's relationship with the firm, whether as a contractor, employee or owner[3]. Given the holistic nature of the revised and restructured IESBA Code, the NZAuASB believes that it is appropriate to amend PES 1 to incorporate Part 2 in its entirety.

9. Amending PES 1 to include Part 2 is expected to be beneficial to all assurance practitioners by providing all ethical requirements in one place.

1.4 Timeline and next steps

10. Submissions on ED 2020-1 are due by 31 May 2020. Information on how to make submissions is provided on page 3 of this Invitation to Comment.

11. After the consultation period ends, we will consider the submissions received, and subject to the comments in those submissions, we expect to finalise and issue amendments to PES 1.

[3] Professional and Ethical Standard 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand),* paragraph NZ R300.5

2. Overview of ED NZ 2020-1

2.1 Key Changes

12. The NZAuASB is proposing to amend PES 1 to include Part 2[4] of the IESBA Code. It is possible for assurance practitioners to find themselves in ethically problematic circumstances that do not involve clients and hence face the same issues and ethical dilemmas as PAIBs. Examples of such circumstances include, potential conflicts an assurance practitioner may face when performing work for an employing organisation, facing undue pressure from within the firm, or facing pressure from within the firm to offer inducements. Circumstances such as these are currently addressed in PES 1 by reference to other ethical requirements[5].

13. It is proposed that Part 2 will apply to assurance practitioners when performing assurance services pursuant to their relationship with the firm, whether as a contractor, employee or owner.

14. Certain contextual changes have been made to "New Zealandise" the IESBA wording in Part 2. These include changing the term "professional accountant in business" to "assurance practitioner" and to use New Zealand spelling. These changes are not tracked and do not necessitate use of the NZ prefix.

Question for respondents

1. **Do you agree with the proposal to include Part 2 of the IESBA Code in PES 1 as it relates to assurance practitioners? If not, please explain why not.**

2.2 Consequential Amendments

15. The inclusion of Part 2 in PES 1 necessitates consequential amendments to PES 1. These include amendments to:

[4] International Code of Ethics for Assurance Practitioners (including International Independence Standards), Part 2, *Professional Accountants in Business*

[5] PES 1, paragraph NZ R300.5 states, "When dealing with an ethics issue, the assurance practitioner shall consider the context in which the issue has arisen or might arise. Where an individual who is an assurance practitioner is performing assurance services pursuant to the assurance practitioner's relationship with the firm, whether as a contractor, employee or owner, the individual shall comply with any other ethical provisions that apply to these circumstances."

- the Guide to the Code to include a description of Part 2;
- the NZ Preface to delete the reference to specific parts of the IESBA Code;
- the Glossary to add definitions that relate to Part 2; and
- sections 120 and 300 to remove the New Zealand paragraph and replace with the text of the IESBA Code. Inclusion of Part 2 in PES 1 eliminates the need for New Zealand specific requirements relating to its applicability.

> **Question for respondents**
>
> **3. Do you agree with the proposed consequential amendments to PES 1? If not, please explain why not.**

2.3 Effective Date

16. The NZAuASB proposes the revisions be effective on 15 September 2020.

17. The NZAuASB proposes a limited implementation period on the basis that assurance practitioners are currently required to comply with other ethical requirements to address the circumstances addressed by the inclusion of Part 2.

> **Question for respondents**
>
> **4. Do you agree with the proposed effective date? If not, please explain why not.**

EXPOSURE DRAFT NZAuASB 2020-2

Proposed Amendments to Professional and Ethical Standard 1: ***Part 2 Assurance Practitioners Performing Professional Activities Pursuant to Their Relationship with the Firm***

CONTENTS

A: INTRODUCTION

This document sets out proposed amendments to Professional and Ethical Standard 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*.

Section B of this document amends Professional and Ethical Standard 1 to include Part 2 of the International Code of Ethics for Professional Accountants (including International Independence Standards) issued by the IESBA.

Section C of this document proposes consequential amendments to other parts of Professional and Ethical Standard 1 that are necessary to reflect the inclusion of Part 2. Amended paragraphs are shown with new text underlined and deleted text struck through.

B: PART 2 – ASSURANCE PRACTITIONERS PERFORMING PROFESSIONAL ACTIVITIES PURSUANT TO THEIR RELATIONSHIP WITH THE FIRM

PART 2 – ASSURANCE PRACTITIONERS PERFORMING PROFESSIONAL ACTIVITIES PURSUANT TO THEIR RELATIONSHIP WITH THE FIRM

SECTION 200

APPLYING THE CONCEPTUAL FRAMEWORK – ASSURANCE PRACTITIONERS PERFORMING PROFESSIONAL ACTIVITIES PURSUANT TO THEIR RELATIONSHIP WITH THE FIRM.

Introduction

200.1 This Part of the Code sets out requirements and application material for assurance practitioners, performing professional activities pursuant to their relationship with the firm, when applying the conceptual framework set out in Section 120. It does not describe all of the facts and circumstances, including professional activities, interests and relationships, that could be encountered by assurance practitioners, which create or might create threats to compliance with the fundamental principles. Therefore, the conceptual framework requires assurance practitioners to be alert for such facts and circumstances.

200.2 Investors, creditors, employing organisations and other sectors of the business community, as well as governments and the general public, might rely on the work of assurance practitioners. Assurance practitioners might be solely or jointly responsible for the preparation and reporting of financial and other information, on which both their employing organisations and third parties might rely. They might also be responsible for providing effective financial management and competent advice on a variety of business-related matters.

200.3 An assurance practitioner might be an employee, contractor, partner, director (executive or non-executive), owner-manager, or volunteer of an employing organisation. The legal form of the relationship of the assurance practitioner with the employing organisation has no bearing on the ethical responsibilities placed on the assurance practitioner.

200.4 *[Amended by the NZAuASB]*

NZ 200.4 In this Part, the term "assurance practitioner" refers to an individual who is an assurance practitioner when performing professional activities pursuant to the assurance practitioner's relationship with the assurance practitioner's firm, whether as a contractor, employee or owner. More information on when Part 2 is applicable to assurance practitioners is set out in paragraphs R120.4, R300.5 and 300.5 A1.

Requirements and Application Material

General

R200.5 An assurance practitioner shall comply with the fundamental principles set out in Section 110 and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to compliance with the fundamental principles.

200.5 A1 An assurance practitioner has a responsibility to further the legitimate objectives of the assurance practitioner's employing organisation. The Code does not seek to hinder assurance practitioners from fulfilling that responsibility, but addresses circumstances in which compliance with the fundamental principles might be compromised.

200.5 A2 Assurance practitioners may promote the position of the employing organisation when furthering the legitimate goals and objectives of their employing organisation, provided that any statements made are neither false nor misleading. Such actions usually would not create an advocacy threat.

200.5 A3 The more senior the position of an assurance practitioner, the greater will be the ability and opportunity to access information, and to influence policies, decisions made and actions taken by others involved with the employing organisation. To the extent that they are able to do so, taking into account their position and seniority in the organisation, assurance practitioners are expected to encourage and promote an ethics-based culture in the organisation. Examples of actions that might be taken include the introduction, implementation and oversight of:

- Ethics education and training programs.
- Ethics and whistle-blowing policies.
- Policies and procedures designed to prevent non-compliance with laws and regulations.

Identifying Threats

200.6 A1 Threats to compliance with the fundamental principles might be created by a broad range of facts and circumstances. The categories of threats are described in paragraph 120.6 A3. The following are examples of facts and circumstances within each of those categories that might create threats for an assurance practitioner when undertaking a professional activity:

(a) Self-interest Threats

- An assurance practitioner holding a financial interest in, or receiving a loan or guarantee from, the employing organisation.
- An assurance practitioner participating in incentive compensation arrangements offered by the employing organisation.
- An assurance practitioner having access to corporate assets for personal use.
- An assurance practitioner being offered a gift or special treatment from a supplier of the employing organisation.

(b) Self-review Threats

- An assurance practitioner determining the appropriate accounting treatment for a business combination after performing the feasibility study supporting the purchase decision.

(c) Advocacy Threats

- An assurance practitioner having the opportunity to manipulate information in a prospectus in order to obtain favourable financing.

(d) Familiarity Threats

- An assurance practitioner being responsible for the financial reporting of the employing organisation when an immediate or close family member employed by the organisation makes decisions that affect the financial reporting of the organisation.
- An assurance practitioner having a long association with individuals influencing business decisions.

(e) Intimidation Threats

- An assurance practitioner or immediate or close family member facing the threat of dismissal or replacement over a disagreement about:
  - The application of an accounting principle.
  - The way in which financial information is to be reported.
- An individual attempting to influence the decision-making process of the assurance practitioner, for example with regard to the awarding of contracts or the application of an accounting principle.

Evaluating Threats

200.7 A1 The conditions, policies and procedures described in paragraphs 120.6 A1 and 120.8 A2 might impact the evaluation of whether a threat to compliance with the fundamental principles is at an acceptable level.

200.7 A2 The assurance practitioner's evaluation of the level of a threat is also impacted by the nature and scope of the professional activity.

200.7 A3 The assurance practitioner's evaluation of the level of a threat might be impacted by the work environment within the employing organisation and its operating environment. For example:

- Leadership that stresses the importance of ethical behaviour and the expectation that employees will act in an ethical manner.
- Policies and procedures to empower and encourage employees to communicate ethics issues that concern them to senior levels of management without fear of retribution.
- Policies and procedures to implement and monitor the quality of employee performance.

- Systems of corporate oversight or other oversight structures and strong internal controls.
- Recruitment procedures emphasising the importance of employing high calibre competent personnel.
- Timely communication of policies and procedures, including any changes to them, to all employees, and appropriate training and education on such policies and procedures.
- Ethics and code of conduct policies.

200.7 A4 Assurance practitioners might consider obtaining legal advice where they believe that unethical behaviour or actions by others have occurred, or will continue to occur, within the employing organisation.

Addressing Threats

200.8 A1 Sections 210 to 270 describe certain threats that might arise during the course of performing professional activities and include examples of actions that might address such threats.

200.8 A2 In extreme situations, if the circumstances that created the threats cannot be eliminated and safeguards are not available or capable of being applied to reduce the threat to an acceptable level, it might be appropriate for an assurance practitioner to resign from the employing organisation.

Communicating with Those Charged with Governance

R200.9 When communicating with those charged with governance in accordance with the Code, an assurance practitioner shall determine the appropriate individual(s) within the employing organisation's governance structure with whom to communicate. If the assurance practitioner communicates with a subgroup of those charged with governance, the assurance practitioner shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

200.9 A1 In determining with whom to communicate, an assurance practitioner might consider:

(a) The nature and importance of the circumstances; and

(b) The matter to be communicated.

200.9 A2 Examples of a subgroup of those charged with governance include an audit committee or an individual member of those charged with governance.

R200.10 If an assurance practitioner communicates with individuals who have management responsibilities as well as governance responsibilities, the assurance practitioner shall be satisfied that communication with those individuals adequately informs all of those in a governance role with whom the assurance practitioner would otherwise communicate.

200.10 A1 In some circumstances, all of those charged with governance are involved in managing the employing organisation, for example, a small business where a single owner manages the organisation and no one else has a governance role. In these cases, if matters are communicated with individual(s) with management responsibilities, and those individual(s) also have governance responsibilities, the assurance practitioner has satisfied the requirement to communicate with those charged with governance.

SECTION 210

CONFLICTS OF INTEREST

Introduction

210.1 Assurance practitioners are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

210.2 A conflict of interest creates threats to compliance with the principle of objectivity and might create threats to compliance with the other fundamental principles. Such threats might be created when:

(a) An assurance practitioner undertakes a professional activity related to a particular matter for two or more parties whose interests with respect to that matter are in conflict; or

(b) The interest of an assurance practitioner with respect to a particular matter and the interests of a party for whom the assurance practitioner undertakes a professional activity related to that matter are in conflict.

A party might include an employing organisation, a vendor, a customer, a lender, a shareholder, or another party.

210.3 This section sets out specific requirements and application material relevant to applying the conceptual framework to conflicts of interest.

Requirements and Application Material

General

R210.4 An assurance practitioner shall not allow a conflict of interest to compromise professional or business judgement.

210.4 A1 Examples of circumstances that might create a conflict of interest include:

- Serving in a management or governance position for two employing organisations and acquiring confidential information from one organisation that might be used by the assurance practitioner to the advantage or disadvantage of the other organisation.
- Undertaking a professional activity for each of two parties in a partnership, where both parties are employing the assurance practitioner to assist them to dissolve their partnership.
- Preparing financial information for certain members of management of the assurance practitioner’s employing organisation who are seeking to undertake a management buy-out.
- Being responsible for selecting a vendor for the employing organisation when an immediate family member of the assurance practitioner might benefit financially from the transaction.
- Serving in a governance capacity in an employing organisation that is approving certain investments for the company where one of those investments will increase

the value of the investment portfolio of the assurance practitioner or an immediate family member.

Conflict Identification

R210.5 An assurance practitioner shall take reasonable steps to identify circumstances that might create a conflict of interest, and therefore a threat to compliance with one or more of the fundamental principles. Such steps shall include identifying:

(a) The nature of the relevant interests and relationships between the parties involved; and

(b) The activity and its implication for relevant parties.

R210.6 An assurance practitioner shall remain alert to changes over time in the nature of the activities, interests and relationships that might create a conflict of interest while performing a professional activity.

Threats Created by Conflicts of Interest

210.7 A1 In general, the more direct the connection between the professional activity and the matter on which the parties' interests conflict, the more likely the level of the threat is not at an acceptable level.

210.7 A2 An example of an action that might eliminate threats created by conflicts of interest is withdrawing from the decision-making process related to the matter giving rise to the conflict of interest.

210.7 A3 Examples of actions that might be safeguards to address threats created by conflicts of interest include:

- Restructuring or segregating certain responsibilities and duties.
- Obtaining appropriate oversight, for example, acting under the supervision of an executive or non-executive director.

Disclosure and Consent

General

210.8 A1 It is generally necessary to:

(a) Disclose the nature of the conflict of interest and how any threats created were addressed to the relevant parties, including to the appropriate levels within the employing organisation affected by a conflict; and

(b) Obtain consent from the relevant parties for the assurance practitioner to undertake the professional activity when safeguards are applied to address the threat.

Commented [SW1]: Part 3 (NZ R 310.9.1 and NZ R310.9.2) of PES 1 requires disclosure and consent to be in writing.

NZICA has modified this application paragraph in its Code to add "in writing" in subparagraphs (a) and (b).

210.8 A2 Consent might be implied by a party's conduct in circumstances where the assurance practitioner has sufficient evidence to conclude that the parties know the circumstances at the outset and have accepted the conflict of interest if they do not raise an objection to the existence of the conflict.

210.8 A3 If such disclosure or consent is not in writing, the assurance practitioner is encouraged to document:

(a) The nature of the circumstances giving rise to the conflict of interest;

(b) The safeguards applied to address the threats when applicable; and

(c) The consent obtained.

Other Considerations

210.9 A1 When addressing a conflict of interest, the assurance practitioner is encouraged to seek guidance from within the employing organisation or from others, such as a professional body, legal counsel or another assurance practitioner. When making such disclosures or sharing information within the employing organisation and seeking guidance of third parties, the principle of confidentiality applies.

SECTION 220

PREPARATION AND PRESENTATION OF INFORMATION

Introduction

220.1 Assurance practitioners are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

220.2 Preparing or presenting information might create a self-interest, intimidation or other threats to compliance with one or more of the fundamental principles. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

220.3 A1 Assurance practitioners at all levels in an employing organisation are involved in the preparation or presentation of information both within and outside the organisation.

220.3 A2 Stakeholders to whom, or for whom, such information is prepared or presented, include:

- Management and those charged with governance.
- Investors and lenders or other creditors.
- Regulatory bodies.

This information might assist stakeholders in understanding and evaluating aspects of the employing organisation's state of affairs and in making decisions concerning the organisation. Information can include financial and non-financial information that might be made public or used for internal purposes.

Examples include:

- Operating and performance reports.
- Decision support analyses.
- Budgets and forecasts.
- Information provided to the internal and external auditors.
- Risk analyses.
- General and special purpose financial statements.
- Tax returns.
- Reports filed with regulatory bodies for legal and compliance purposes.

220.3 A3 For the purposes of this section, preparing or presenting information includes recording, maintaining and approving information.

R220.4 When preparing or presenting information, an assurance practitioner shall:

(a) Prepare or present the information in accordance with a relevant reporting framework, where applicable;

(b) Prepare or present the information in a manner that is intended neither to mislead nor to influence contractual or regulatory outcomes inappropriately;

(c) Exercise professional judgement to:

- **(i)** Represent the facts accurately and completely in all material respects;
- **(ii)** Describe clearly the true nature of business transactions or activities; and
- **(iii)** Classify and record information in a timely and proper manner; and

(d) Not omit anything with the intention of rendering the information misleading or of influencing contractual or regulatory outcomes inappropriately.

220.4 A1 An example of influencing a contractual or regulatory outcome inappropriately is using an unrealistic estimate with the intention of avoiding violation of a contractual requirement such as a debt covenant or of a regulatory requirement such as a capital requirement for a financial institution.

Use of Discretion in Preparing or Presenting Information

R220.5 Preparing or presenting information might require the exercise of discretion in making professional judgements. The assurance practitioner shall not exercise such discretion with the intention of misleading others or influencing contractual or regulatory outcomes inappropriately.

220.5 A1 Examples of ways in which discretion might be misused to achieve inappropriate outcomes include:

- Determining estimates, for example, determining fair value estimates in order to misrepresent profit or loss.
- Selecting or changing an accounting policy or method among two or more alternatives permitted under the applicable financial reporting framework, for example, selecting a policy for accounting for long-term contracts in order to misrepresent profit or loss.
- Determining the timing of transactions, for example, timing the sale of an asset near the end of the fiscal year in order to mislead.
- Determining the structuring of transactions, for example, structuring financing transactions in order to misrepresent assets and liabilities or classification of cash flows.
- Selecting disclosures, for example, omitting or obscuring information relating to financial or operating risk in order to mislead.

R220.6 When performing professional activities, especially those that do not require compliance with a relevant reporting framework, the assurance practitioner shall exercise professional judgement to identify and consider:

(a) The purpose for which the information is to be used;

(b) The context within which it is given; and

(c) The audience to whom it is addressed.

220.6 A1 For example, when preparing or presenting pro forma reports, budgets or forecasts, the inclusion of relevant estimates, approximations and assumptions, where appropriate, would enable those who might rely on such information to form their own judgements.

220.6 A2 The assurance practitioner might also consider clarifying the intended audience, context and purpose of the information to be presented.

Relying on the Work of Others

R220.7 An assurance practitioner who intends to rely on the work of others, either internal or external to the employing organisation, shall exercise professional judgement to determine what steps to take, if any, in order to fulfil the responsibilities set out in paragraph R220.4.

220.7 A1 Factors to consider in determining whether reliance on others is reasonable include:

- The reputation and expertise of, and resources available to, the other individual or organisation.
- Whether the other individual is subject to applicable professional and ethics standards.

Such information might be gained from prior association with, or from consulting others about, the other individual or organisation.

Addressing Information that Is or Might be Misleading

R220.8 When the assurance practitioner knows or has reason to believe that the information with which the assurance practitioner is associated is misleading, the assurance practitioner shall take appropriate actions to seek to resolve the matter.

220.8 A1 Actions that might be appropriate include:

- Discussing concerns that the information is misleading with the assurance practitioner's superior and/or the appropriate level(s) of management within the assurance practitioner's employing organisation or those charged with governance, and requesting such individuals to take appropriate action to resolve the matter. Such action might include:
  - Having the information corrected.
  - If the information has already been disclosed to the intended users, informing them of the correct information.
- Consulting the policies and procedures of the employing organisation (for example, an ethics or whistle-blowing policy) regarding how to address such matters internally.

220.8 A2 The assurance practitioner might determine that the employing organisation has not taken appropriate action. If the assurance practitioner continues to have reason to believe that the information is misleading, the following further actions might be appropriate provided that the assurance practitioner remains alert to the principle of confidentiality:

- Consulting with:
    - A relevant professional body.
    - The internal or external auditor of the employing organisation.
    - Legal counsel.
- Determining whether any requirements exist to communicate to:
    - Third parties, including users of the information.
    - Regulatory and oversight authorities.

R220.9 If after exhausting all feasible options, the assurance practitioner determines that appropriate action has not been taken and there is reason to believe that the information is still misleading, the assurance practitioner shall refuse to be or to remain associated with the information.

220.9 A1 In such circumstances, it might be appropriate for an assurance practitioner to resign from the employing organisation.

Documentation

220.10 A1 The assurance practitioner is encouraged to document:

- The facts.
- The accounting principles or other relevant professional standards involved.
- The communications and parties with whom matters were discussed.
- The courses of action considered.
- How the assurance practitioner attempted to address the matter(s).

Other Considerations

220.11 A1 Where threats to compliance with the fundamental principles relating to the preparation or presentation of information arise from a financial interest, including compensation and incentives linked to financial reporting and decision making, the requirements and application material set out in Section 240 apply.

220.11 A2 Where the misleading information might involve non-compliance with laws and regulations, the requirements and application material set out in Section 260 apply.

220.11 A3 Where threats to compliance with the fundamental principles relating to the preparation or presentation of information arise from pressure, the requirements and application material set out in Section 270 apply.

Commented [SW2]: Refer issues paper.

SECTION 230

ACTING WITH SUFFICIENT EXPERTISE

Introduction

230.1 Assurance practitioners are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

230.2 Acting without sufficient expertise creates a self-interest threat to compliance with the principle of professional competence and due care. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

R230.3 An assurance practitioner shall not intentionally mislead an employing organisation as to the level of expertise or experience possessed.

230.3 A1 The principle of professional competence and due care requires that an assurance practitioner only undertake significant tasks for which the assurance practitioner has, or can obtain, sufficient training or experience.

230.3 A2 A self-interest threat to compliance with the principle of professional competence and due care might be created if an assurance practitioner has:

- Insufficient time for performing or completing the relevant duties.
- Incomplete, restricted or otherwise inadequate information for performing the duties.
- Insufficient experience, training and/or education.
- Inadequate resources for the performance of the duties.

230.3 A3 Factors that are relevant in evaluating the level of such a threat include:

- The extent to which the assurance practitioner is working with others.
- The relative seniority of the assurance practitioner in the business.
- The level of supervision and review applied to the work.

230.3 A4 Examples of actions that might be safeguards to address such a self-interest threat include:

- Obtaining assistance or training from someone with the necessary expertise.
- Ensuring that there is adequate time available for performing the relevant duties.

R230.4 If a threat to compliance with the principle of professional competence and due care cannot be addressed, an assurance practitioner shall determine whether to decline to perform the duties in question. If the assurance practitioner determines that declining is appropriate, the assurance practitioner shall communicate the reasons.

Other Considerations

230.5 A1 The requirements and application material in Section 270 apply when an assurance practitioner is pressured to act in a manner that might lead to a breach of the principle of professional competence and due care.

SECTION 240

FINANCIAL INTERESTS, COMPENSATION AND INCENTIVES LINKED TO FINANCIAL REPORTING AND DECISION MAKING

Introduction

240.1 Assurance practitioners are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

240.2 Having a financial interest, or knowing of a financial interest held by an immediate or close family member might create a self-interest threat to compliance with the principles of objectivity or confidentiality. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

R240.3 An assurance practitioner shall not manipulate information or use confidential information for personal gain or for the financial gain of others.

240.3 A1 Assurance practitioners might have financial interests or might know of financial interests of immediate or close family members that, in certain circumstances, might create threats to compliance with the fundamental principles. Financial interests include those arising from compensation or incentive arrangements linked to financial reporting and decision making.

240.3 A2 Examples of circumstances that might create a self-interest threat include situations in which the assurance practitioner or an immediate or close family member:

- Has a motive and opportunity to manipulate price-sensitive information in order to gain financially.
- Holds a direct or indirect financial interest in the employing organisation and the value of that financial interest might be directly affected by decisions made by the assurance practitioner.
- Is eligible for a profit-related bonus and the value of that bonus might be directly affected by decisions made by the assurance practitioner.
- Holds, directly or indirectly, deferred bonus share rights or share options in the employing organisation, the value of which might be affected by decisions made by the assurance practitioner.
- Participates in compensation arrangements which provide incentives to achieve targets or to support efforts to maximise the value of the employing organisation's shares. An example of such an arrangement might be through participation in incentive plans which are linked to certain performance conditions being met.

240.3 A3 Factors that are relevant in evaluating the level of such a threat include:

- The significance of the financial interest. What constitutes a significant financial interest will depend on personal circumstances and the materiality of the financial interest to the individual.
- Policies and procedures for a committee independent of management to determine the level or form of senior management remuneration.
- In accordance with any internal policies, disclosure to those charged with governance of:
    - All relevant interests.
    - Any plans to exercise entitlements or trade in relevant shares.
- Internal and external audit procedures that are specific to address issues that give rise to the financial interest.

240.3 A4 Threats created by compensation or incentive arrangements might be compounded by explicit or implicit pressure from superiors or colleagues. See Section 270, *Pressure to Breach the Fundamental Principles*.

SECTION 250

INDUCEMENTS, INCLUDING GIFTS AND HOSPITALITY

Introduction

250.1 Assurance practitioners are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

250.2 Offering or accepting inducements might create a self-interest, familiarity or intimidation threat to compliance with the fundamental principles, particularly the principles of integrity, objectivity and professional behaviour.

250.3 This section sets out requirements and application material relevant to applying the conceptual framework in relation to the offering and accepting of inducements when undertaking professional activities that does not constitute non-compliance with laws and regulations. This section also requires an assurance practitioner to comply with relevant laws and regulations when offering or accepting inducements.

Requirements and Application Material

General

250.4 A1 An inducement is an object, situation, or action that is used as a means to influence another individual's behaviour, but not necessarily with the intent to improperly influence that individual's behaviour. Inducements can range from minor acts of hospitality between business colleagues to acts that result in non-compliance with laws and regulations. An inducement can take many different forms, for example:

- Gifts.
- Hospitality.
- Entertainment.
- Political or charitable donations.
- Appeals to friendship and loyalty.
- Employment or other commercial opportunities.
- Preferential treatment, rights or privileges.

Inducements Prohibited by Laws and Regulations

R250.5 In many jurisdictions, there are laws and regulations, such as those related to bribery and corruption, that prohibit the offering or accepting of inducements in certain circumstances. The assurance practitioner shall obtain an understanding of relevant laws and regulations and comply with them when the assurance practitioner encounters such circumstances.

Inducements Not Prohibited by Laws and Regulations

250.6 A1 The offering or accepting of inducements that is not prohibited by laws and regulations might still create threats to compliance with the fundamental principles.

Inducements with Intent to Improperly Influence Behaviour

R250.7 An assurance practitioner shall not offer, or encourage others to offer, any inducement that is made, or which the assurance practitioner considers a reasonable and informed third party would be likely to conclude is made, with the intent to improperly influence the behaviour of the recipient or of another individual.

R250.8 An assurance practitioner shall not accept, or encourage others to accept, any inducement that the assurance practitioner concludes is made, or considers a reasonable and informed third party would be likely to conclude is made, with the intent to improperly influence the behaviour of the recipient or of another individual.

250.9 A1 An inducement is considered as improperly influencing an individual's behaviour if it causes the individual to act in an unethical manner. Such improper influence can be directed either towards the recipient or towards another individual who has some relationship with the recipient. The fundamental principles are an appropriate frame of reference for an assurance practitioner in considering what constitutes unethical behaviour on the part of the assurance practitioner and, if necessary by analogy, other individuals.

250.9 A2 A breach of the fundamental principle of integrity arises when an assurance practitioner offers or accepts, or encourages others to offer or accept, an inducement where the intent is to improperly influence the behaviour of the recipient or of another individual.

250.9 A3 The determination of whether there is actual or perceived intent to improperly influence behaviour requires the exercise of professional judgement. Relevant factors to consider might include:

- The nature, frequency, value and cumulative effect of the inducement.
- Timing of when the inducement is offered relative to any action or decision that it might influence.
- Whether the inducement is a customary or cultural practice in the circumstances, for example, offering a gift on the occasion of a religious holiday or wedding.
- Whether the inducement is an ancillary part of a professional activity, for example, offering or accepting lunch in connection with a business meeting.
- Whether the offer of the inducement is limited to an individual recipient or available to a broader group. The broader group might be internal or external to the employing organisation, such as other customers or vendors.
- The roles and positions of the individuals offering or being offered the inducement.
- Whether the assurance practitioner knows, or has reason to believe, that accepting the inducement would breach the policies and procedures of the counterparty's employing organisation.

- The degree of transparency with which the inducement is offered.
- Whether the inducement was required or requested by the recipient.
- The known previous behaviour or reputation of the offeror.

Consideration of Further Actions

250.10 A1 If the assurance practitioner becomes aware of an inducement offered with actual or perceived intent to improperly influence behaviour, threats to compliance with the fundamental principles might still be created even if the requirements in paragraphs R250.7 and R250.8 are met.

250.10 A2 Examples of actions that might be safeguards to address such threats include:

- Informing senior management or those charged with governance of the employing organisation of the assurance practitioner or the offeror regarding the offer.
- Amending or terminating the business relationship with the offeror.

Inducements with No Intent to Improperly Influence Behaviour

250.11 A1 The requirements and application material set out in the conceptual framework apply when an assurance practitioner has concluded there is no actual or perceived intent to improperly influence the behaviour of the recipient or of another individual.

250.11 A2 If such an inducement is trivial and inconsequential, any threats created will be at an acceptable level.

250.11 A3 Examples of circumstances where offering or accepting such an inducement might create threats even if the assurance practitioner has concluded there is no actual or perceived intent to improperly influence behaviour include:

- Self-interest threats
    - An assurance practitioner is offered part-time employment by a vendor.
- Familiarity threats
    - An assurance practitioner regularly takes a customer or supplier to sporting events.
- Intimidation threats
    - An assurance practitioner accepts hospitality, the nature of which could be perceived to be inappropriate were it to be publicly disclosed.

250.11 A4 Relevant factors in evaluating the level of such threats created by offering or accepting such an inducement include the same factors set out in paragraph 250.9 A3 for determining intent.

250.11 A5 Examples of actions that might eliminate threats created by offering or accepting such an inducement include:

- Declining or not offering the inducement.

- Transferring responsibility for any business-related decision involving the counterparty to another individual who the assurance practitioner has no reason to believe would be, or would be perceived to be, improperly influenced in making the decision.

250.11 A6 Examples of actions that might be safeguards to address such threats created by offering or accepting such an inducement include:

- Being transparent with senior management or those charged with governance of the employing organisation of the assurance practitioner or of the counterparty about offering or accepting an inducement.
- Registering the inducement in a log maintained by the employing organisation of the assurance practitioner or the counterparty.
- Having an appropriate reviewer, who is not otherwise involved in undertaking the professional activity, review any work performed or decisions made by the assurance practitioner with respect to the individual or organisation from which the assurance practitioner accepted the inducement.
- Donating the inducement to charity after receipt and appropriately disclosing the donation, for example, to those charged with governance or the individual who offered the inducement.
- Reimbursing the cost of the inducement, such as hospitality, received.
- As soon as possible, returning the inducement, such as a gift, after it was initially accepted.

Immediate or Close Family Members

R250.12 An assurance practitioner shall remain alert to potential threats to the assurance practitioner's compliance with the fundamental principles created by the offering of an inducement:

(a) By an immediate or close family member of the assurance practitioner to a counterparty with whom the assurance practitioner has a professional relationship; or

(b) To an immediate or close family member of the assurance practitioner by a counterparty with whom the assurance practitioner has a professional relationship.

R250.13 Where the assurance practitioner becomes aware of an inducement being offered to or made by an immediate or close family member and concludes there is intent to improperly influence the behaviour of the assurance practitioner or of the counterparty, or considers a reasonable and informed third party would be likely to conclude such intent exists, the assurance practitioner shall advise the immediate or close family member not to offer or accept the inducement.

250.13 A1 The factors set out in paragraph 250.9 A3 are relevant in determining whether there is actual or perceived intent to improperly influence the behaviour of the assurance practitioner or of the counterparty. Another factor that is relevant is the nature or closeness of the relationship, between:

(a) The assurance practitioner and the immediate or close family member;

(b) The immediate or close family member and the counterparty; and

(c) The assurance practitioner and the counterparty.

For example, the offer of employment, outside of the normal recruitment process, to the spouse of the assurance practitioner by a counterparty with whom the assurance practitioner is negotiating a significant contract might indicate such intent.

250.13 A2 The application material in paragraph 250.10 A2 is also relevant in addressing threats that might be created when there is actual or perceived intent to improperly influence the behaviour of the assurance practitioner or of the counterparty even if the immediate or close family member has followed the advice given pursuant to paragraph R250.13.

Application of the Conceptual Framework

250.14 A1 Where the assurance practitioner becomes aware of an inducement offered in the circumstances addressed in paragraph R250.12, threats to compliance with the fundamental principles might be created where:

(a) The immediate or close family member offers or accepts the inducement contrary to the advice of the assurance practitioner pursuant to paragraph R250.13; or

(b) The assurance practitioner does not have reason to believe an actual or perceived intent to improperly influence the behaviour of the assurance practitioner or of the counterparty exists.

250.14 A2 The application material in paragraphs 250.11 A1 to 250.11 A6 is relevant for the purposes of identifying, evaluating and addressing such threats. Factors that are relevant in evaluating the level of threats in these circumstances also include the nature or closeness of the relationships set out in paragraph 250.13 A1.

Other Considerations

250.15 A1 If an assurance practitioner is offered an inducement by the employing organisation relating to financial interests, compensation and incentives linked to performance, the requirements and application material set out in Section 240 apply.

250.15 A2 If an assurance practitioner encounters or is made aware of inducements that might result in non-compliance or suspected non-compliance with laws and regulations by other individuals working for or under the direction of the employing organisation, the requirements and application material set out in Section 260 apply.

250.15 A3 If an assurance practitioner faces pressure to offer or accept inducements that might create threats to compliance with the fundamental principles, the requirements and application material set out in Section 270 apply.

SECTION 260

RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS

Introduction

260.1 Assurance practitioners are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

260.2 A self-interest or intimidation threat to compliance with the principles of integrity and professional behaviour is created when an assurance practitioner becomes aware of non-compliance or suspected non-compliance with laws and regulations.

260.3 An assurance practitioner might encounter or be made aware of non-compliance or suspected non-compliance in the course of carrying out professional activities. This section guides the assurance practitioner in assessing the implications of the matter and the possible courses of action when responding to non-compliance or suspected non-compliance with:

(a) Laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the employing organisation's financial statements; and

(b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the employing organisation's financial statements, but compliance with which might be fundamental to the operating aspects of the employing organisation's business, to its ability to continue its business, or to avoid material penalties.

Objectives of the Assurance Practitioner in Relation to Non-compliance with Laws and Regulations

260.4 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. When responding to non-compliance or suspected non-compliance, the objectives of the assurance practitioner are:

(a) To comply with the principles of integrity and professional behaviour;

(b) By alerting management or, where appropriate, those charged with governance of the employing organisation, to seek to:

(i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or

(ii) Deter the non-compliance where it has not yet occurred; and

(c) To take such further action as appropriate in the public interest.

Requirements and Application Material

General

260.5 A1 Non-compliance with laws and regulations (“non-compliance”) comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:

(a) The assurance practitioner’s employing organisation;

(b) Those charged with governance of the employing organisation;

(c) Management of the employing organisation; or

(d) Other individuals working for or under the direction of the employing organisation.

260.5 A2 Examples of laws and regulations which this section addresses include those that deal with:

- Fraud, corruption and bribery.
- Money laundering, terrorist financing and proceeds of crime.
- Securities markets and trading.
- Banking and other financial products and services.
- Data protection.
- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

260.5 A3 Non-compliance might result in fines, litigation or other consequences for the employing organisation, potentially materially affecting its financial statements. Importantly, such non-compliance might have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees or the general public. For the purposes of this section, non-compliance that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or non-financial terms. Examples include the perpetration of a fraud resulting in significant financial losses to investors, and breaches of environmental laws and regulations endangering the health or safety of employees or the public.

R260.6 In some jurisdictions, there are legal or regulatory provisions governing how assurance practitioners are required to address non-compliance or suspected non-compliance. These legal or regulatory provisions might differ from or go beyond the provisions in this section. When encountering such non-compliance or suspected non-compliance, the assurance practitioner shall obtain an understanding of those legal or regulatory provisions and comply with them, including:

(a) Any requirement to report the matter to an appropriate authority; and

(b) Any prohibition on alerting the relevant party.

260.6 A1 A prohibition on alerting the relevant party might arise, for example, pursuant to anti-money laundering legislation.

260.7 A1 This section applies regardless of the nature of the employing organisation, including whether or not it is a public interest entity.

260.7 A2 An assurance practitioner who encounters or is made aware of matters that are clearly inconsequential is not required to comply with this section. Whether a matter is clearly inconsequential is to be judged with respect to its nature and its impact, financial or otherwise, on the employing organisation, its stakeholders and the general public.

260.7 A3 This section does not address:

(a) Personal misconduct unrelated to the business activities of the employing organisation; and

(b) Non-compliance by parties other than those specified in paragraph 260.5 A1.

The assurance practitioner might nevertheless find the guidance in this section helpful in considering how to respond in these situations.

Responsibilities of the Employing Organisation's Management and Those Charged with Governance

260.8 A1 The employing organisation's management, with the oversight of those charged with governance, is responsible for ensuring that the employing organisation's business activities are conducted in accordance with laws and regulations. Management and those charged with governance are also responsible for identifying and addressing any non-compliance by:

(a) The employing organisation;

(b) An individual charged with governance of the employing organisation;

(c) A member of management; or

(d) Other individuals working for or under the direction of the employing organisation.

Responsibilities of All Assurance Practitioners

R260.9 If protocols and procedures exist within the assurance practitioner's employing organisation to address non-compliance or suspected non-compliance, the assurance practitioner shall consider them in determining how to respond to such non-compliance.

260.9 A1 Many employing organisations have established protocols and procedures regarding how to raise non-compliance or suspected non-compliance internally. These protocols and procedures include, for example, an ethics policy or internal whistle-blowing mechanism. Such protocols and procedures might allow matters to be reported anonymously through designated channels.

R260.10 Where an assurance practitioner becomes aware of a matter to which this section applies, the steps that the assurance practitioner takes to comply with this section shall be taken on a timely basis. For the purpose of taking timely steps, the assurance practitioner shall have regard to the nature of the matter and the potential harm to the interests of the employing organisation, investors, creditors, employees or the general public.

Responsibilities of Senior Assurance Practitioners

260.11 A1 Senior assurance practitioners are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organisation's human, financial, technological, physical and intangible resources. There is a greater expectation for such individuals to take whatever action is appropriate in the public interest to respond to non-compliance or suspected non-compliance than other assurance practitioners within the employing organisation. This is because of senior assurance practitioners' roles, positions and spheres of influence within the employing organisation.

Obtaining an Understanding of the Matter

R260.12 If, in the course of carrying out professional activities, a senior assurance practitioner becomes aware of information concerning non-compliance or suspected non-compliance, the senior assurance practitioner shall obtain an understanding of the matter. This understanding shall include:

(a) The nature of the non-compliance or suspected non-compliance and the circumstances in which it has occurred or might occur;

(b) The application of the relevant laws and regulations to the circumstances; and

(c) An assessment of the potential consequences to the employing organisation, investors, creditors, employees or the wider public.

260.12 A1 A senior assurance practitioner is expected to apply knowledge and expertise, and exercise professional judgement. However, the assurance practitioner is not expected to have a level of understanding of laws and regulations greater than that which is required for the assurance practitioner's role within the employing organisation. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

260.12 A2 Depending on the nature and significance of the matter, the senior assurance practitioner might cause, or take appropriate steps to cause, the matter to be investigated internally. The assurance practitioner might also consult on a confidential basis with others within the employing organisation or a professional body, or with legal counsel.

Addressing the Matter

R260.13 If the senior assurance practitioner identifies or suspects that non-compliance has occurred or might occur, the assurance practitioner shall, subject to paragraph R260.9, discuss the matter with the assurance practitioner's immediate superior, if any. If the assurance practitioner's immediate superior appears to be involved in the matter, the assurance practitioner shall discuss the matter with the next higher level of authority within the employing organisation.

260.13 A1 The purpose of the discussion is to enable a determination to be made as to how to address the matter.

R260.14 The senior assurance practitioner shall also take appropriate steps to:

(a) Have the matter communicated to those charged with governance;

(b) Comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance to an appropriate authority;

(c) Have the consequences of the non-compliance or suspected non-compliance rectified, remediated or mitigated;

(d) Reduce the risk of re-occurrence; and

(e) Seek to deter the commission of the non-compliance if it has not yet occurred.

260.14 A1 The purpose of communicating the matter to those charged with governance is to obtain their concurrence regarding appropriate actions to take to respond to the matter and to enable them to fulfil their responsibilities.

260.14 A2 Some laws and regulations might stipulate a period within which reports of non-compliance or suspected non-compliance are to be made to an appropriate authority.

R260.15 In addition to responding to the matter in accordance with the provisions of this section, the senior assurance practitioner shall determine whether disclosure of the matter to the employing organisation's external auditor, if any, is needed.

260.15 A1 Such disclosure would be pursuant to the senior assurance practitioner's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit.

Determining Whether Further Action Is Needed

R260.16 The senior assurance practitioner shall assess the appropriateness of the response of the assurance practitioner's superiors, if any, and those charged with governance.

260.16 A1 Relevant factors to consider in assessing the appropriateness of the response of the senior assurance practitioner's superiors, if any, and those charged with governance include whether:

- The response is timely.
- They have taken or authorised appropriate action to seek to rectify, remediate or mitigate the consequences of the non-compliance, or to avert the non-compliance if it has not yet occurred.
- The matter has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

R260.17 In light of the response of the senior assurance practitioner's superiors, if any, and those charged with governance, the assurance practitioner shall determine if further action is needed in the public interest.

260.17 A1 The determination of whether further action is needed, and the nature and extent of it, will depend on various factors, including:

- The legal and regulatory framework.
- The urgency of the situation.
- The pervasiveness of the matter throughout the employing organisation.
- Whether the senior assurance practitioner continues to have confidence in the integrity of the assurance practitioner's superiors and those charged with governance.
- Whether the non-compliance or suspected non-compliance is likely to recur.
- Whether there is credible evidence of actual or potential substantial harm to the interests of the employing organisation, investors, creditors, employees or the general public.

260.17 A2 Examples of circumstances that might cause the senior assurance practitioner no longer to have confidence in the integrity of the assurance practitioner's superiors and those charged with governance include situations where:

- The assurance practitioner suspects or has evidence of their involvement or intended involvement in any non-compliance.
- Contrary to legal or regulatory requirements, they have not reported, or authorised the reporting of, the matter to an appropriate authority within a reasonable period.

R260.18 The senior assurance practitioner shall exercise professional judgement in determining the need for, and nature and extent of, further action. In making this determination, the assurance practitioner shall take into account whether a reasonable and informed third party would be likely to conclude that the assurance practitioner has acted appropriately in the public interest.

260.18 A1 Further action that the senior assurance practitioner might take includes:

- Informing the management of the parent entity of the matter if the employing organisation is a member of a group.
- Disclosing the matter to an appropriate authority even when there is no legal or regulatory requirement to do so.
- Resigning from the employing organisation.

260.18 A2 Resigning from the employing organisation is not a substitute for taking other actions that might be needed to achieve the senior assurance practitioner's objectives under this section. In some jurisdictions, however, there might be limitations as to the further actions available to the assurance practitioner. In such circumstances, resignation might be the only available course of action.

Seeking Advice

260.19 A1 As assessment of the matter might involve complex analysis and judgements, the senior assurance practitioner might consider:

- Consulting internally.
- Obtaining legal advice to understand the assurance practitioner's options and the professional or legal implications of taking any particular course of action.
- Consulting on a confidential basis with a regulatory or professional body.

Determining Whether to Disclose the Matter to an Appropriate Authority

260.20 A1 Disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation. Otherwise, the purpose of making disclosure is to enable an appropriate authority to cause the matter to be investigated and action to be taken in the public interest.

260.20 A2 The determination of whether to make such a disclosure depends in particular on the nature and extent of the actual or potential harm that is or might be caused by the matter to investors, creditors, employees or the general public. For example, the senior assurance practitioner might determine that disclosure of the matter to an appropriate authority is an appropriate course of action if:

- The employing organisation is engaged in bribery (for example, of local or foreign government officials for purposes of securing large contracts).
- The employing organisation is regulated and the matter is of such significance as to threaten its license to operate.
- The employing organisation is listed on a securities exchange and the matter might result in adverse consequences to the fair and orderly market in the employing organisation's securities or pose a systemic risk to the financial markets.
- It is likely that the employing organisation would sell products that are harmful to public health or safety.
- The employing organisation is promoting a scheme to its clients to assist them in evading taxes.

260.20 A3 The determination of whether to make such a disclosure will also depend on external factors such as:

- Whether there is an appropriate authority that is able to receive the information, and cause the matter to be investigated and action to be taken. The appropriate authority will depend upon the nature of the matter. For example, the appropriate authority would be a securities regulator in the case of fraudulent financial reporting or an environmental protection agency in the case of a breach of environmental laws and regulations.
- Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation.

- Whether there are actual or potential threats to the physical safety of the senior assurance practitioner or other individuals.

R260.21 If the senior assurance practitioner determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, that disclosure is permitted pursuant to paragraph R114.1(d) of the Code. When making such disclosure, the assurance practitioner shall act in good faith and exercise caution when making statements and assertions.

Imminent Breach

R260.22 In exceptional circumstances, the senior assurance practitioner might become aware of actual or intended conduct that the assurance practitioner has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the employing organisation, the assurance practitioner shall exercise professional judgement and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted pursuant to paragraph R114.1(d) of the Code.

Documentation

260.23 A1 In relation to non-compliance or suspected non-compliance that falls within the scope of this section, the senior assurance practitioner is encouraged to have the following matters documented:

- The matter.
- The results of discussions with the assurance practitioner's superiors, if any, and those charged with governance and other parties.
- How the assurance practitioner's superiors, if any, and those charged with governance have responded to the matter.
- The courses of action the assurance practitioner considered, the judgements made and the decisions that were taken.
- How the assurance practitioner is satisfied that the assurance practitioner has fulfilled the responsibility set out in paragraph R260.17.

Responsibilities of Assurance Practitioners Other than Senior Assurance Practitioners

R260.24 If, in the course of carrying out professional activities, an assurance practitioner becomes aware of information concerning non-compliance or suspected non-compliance, the assurance practitioner shall seek to obtain an understanding of the matter. This understanding shall include the nature of the non-compliance or suspected non-compliance and the circumstances in which it has occurred or might occur.

260.24 A1 The assurance practitioner is expected to apply knowledge and expertise, and exercise professional judgement. However, the assurance practitioner is not expected to have a level of understanding of laws and regulations greater than that which is required for the assurance practitioner's role within the employing organisation. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

260.24 A2 Depending on the nature and significance of the matter, the assurance practitioner might consult on a confidential basis with others within the employing organisation or a professional body, or with legal counsel.

R260.25 If the assurance practitioner identifies or suspects that non-compliance has occurred or might occur, the assurance practitioner shall, subject to paragraph R260.9, inform an immediate superior to enable the superior to take appropriate action. If the assurance practitioner's immediate superior appears to be involved in the matter, the assurance practitioner shall inform the next higher level of authority within the employing organisation.

R260.26 In exceptional circumstances, the assurance practitioner may determine that disclosure of the matter to an appropriate authority is an appropriate course of action. If the assurance practitioner does so pursuant to paragraphs 260.20 A2 and A3, that disclosure is permitted pursuant to paragraph R114.1(d) of the Code. When making such disclosure, the assurance practitioner shall act in good faith and exercise caution when making statements and assertions.

Documentation

260.27 A1 In relation to non-compliance or suspected non-compliance that falls within the scope of this section, the assurance practitioner is encouraged to have the following matters documented:

- The matter.
- The results of discussions with the assurance practitioner's superior, management and, where applicable, those charged with governance and other parties.
- How the assurance practitioner's superior has responded to the matter.
- The courses of action the assurance practitioner considered, the judgements made and the decisions that were taken.

SECTION 270

PRESSURE TO BREACH THE FUNDAMENTAL PRINCIPLES

Introduction

270.1 Assurance practitioners are required to comply with the fundamental principles and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

270.2 Pressure exerted on, or by, an assurance practitioner might create an intimidation or other threat to compliance with one or more of the fundamental principles. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

R270.3 An assurance practitioner shall not:

(a) Allow pressure from others to result in a breach of compliance with the fundamental principles; or

(b) Place pressure on others that the assurance practitioner knows, or has reason to believe, would result in the other individuals breaching the fundamental principles.

270.3 A1 An assurance practitioner might face pressure that creates threats to compliance with the fundamental principles, for example an intimidation threat, when undertaking a professional activity. Pressure might be explicit or implicit and might come from:

- Within the employing organisation, for example, from a colleague or superior.
- An external individual or organisation such as a vendor, customer or lender.
- Internal or external targets and expectations.

270.3 A2 Examples of pressure that might result in threats to compliance with the fundamental principles include:

- Pressure related to conflicts of interest:
  - o Pressure from a family member bidding to act as a vendor to the assurance practitioner's employing organisation to select the family member over another prospective vendor.

  See also Section 210, *Conflicts of Interest*.
- Pressure to influence preparation or presentation of information:
  - o Pressure to report misleading financial results to meet investor, analyst or lender expectations.
  - o Pressure from elected officials on public sector accountants to misrepresent programs or projects to voters.
  - o Pressure from colleagues to misstate income, expenditure or rates of return

to bias decision-making on capital projects and acquisitions.

- Pressure from superiors to approve or process expenditures that are not legitimate business expenses.
- Pressure to suppress internal audit reports containing adverse findings.

See also Section 220, *Preparation and Presentation of Information*.

- Pressure to act without sufficient expertise or due care:
  - Pressure from superiors to inappropriately reduce the extent of work performed.
  - Pressure from superiors to perform a task without sufficient skills or training or within unrealistic deadlines.

  See also Section 230, *Acting with Sufficient Expertise*.
- Pressure related to financial interests:
  - Pressure from superiors, colleagues or others, for example, those who might benefit from participation in compensation or incentive arrangements to manipulate performance indicators.

  See also Section 240, *Financial Interests, Compensation and Incentives Linked to Financial Reporting and Decision Making*.
- Pressure related to inducements:
  - Pressure from others, either internal or external to the employing organisation, to offer inducements to influence inappropriately the judgement or decision making process of an individual or organisation.
  - Pressure from colleagues to accept a bribe or other inducement, for example to accept inappropriate gifts or entertainment from potential vendors in a bidding process.

  See also Section 250, *Inducements, Including Gifts and Hospitality*.
- Pressure related to non-compliance with laws and regulations:
  - Pressure to structure a transaction to evade tax.

  See also Section 260, *Responding to Non-compliance with Laws and Regulations*.

270.3 A3 Factors that are relevant in evaluating the level of threats created by pressure include:

- The intent of the individual who is exerting the pressure and the nature and extent of the pressure.
- The application of laws, regulations, and professional standards to the circumstances.
- The culture and leadership of the employing organisation including the extent to which they reflect or emphasise the importance of ethical behaviour and the expectation that employees will act ethically. For example, a corporate culture

Commented [SW3]: Refer issues paper

that tolerates unethical behaviour might increase the likelihood that the pressure would result in a threat to compliance with the fundamental principles.

- Policies and procedures, if any, that the employing organisation has established, such as ethics or human resources policies that address pressure.

270.3 A4 Discussing the circumstances creating the pressure and consulting with others about those circumstances might assist the assurance practitioner to evaluate the level of the threat. Such discussion and consultation, which requires being alert to the principle of confidentiality, might include:

- Discussing the matter with the individual who is exerting the pressure to seek to resolve it.
- Discussing the matter with the assurance practitioner's superior, if the superior is not the individual exerting the pressure.
- Escalating the matter within the employing organisation, including when appropriate, explaining any consequential risks to the organisation, for example with:
  - Higher levels of management.
  - Internal or external auditors.
  - Those charged with governance.
- Disclosing the matter in line with the employing organisation's policies, including ethics and whistleblowing policies, using any established mechanism, such as a confidential ethics hotline.
- Consulting with:
  - A colleague, superior, human resources personnel, or another assurance practitioner;
  - Relevant professional or regulatory bodies or industry associations; or
  - Legal counsel.

270.3 A5 An example of an action that might eliminate threats created by pressure is the assurance practitioner's request for a restructure of, or segregation of, certain responsibilities and duties so that the assurance practitioner is no longer involved with the individual or entity exerting the pressure.

Documentation

270.4 A1 The assurance practitioner is encouraged to document:

- The facts.
- The communications and parties with whom these matters were discussed.
- The courses of action considered.
- How the matter was addressed.

C: CONSEQUENTIAL AMENDMENTS

Commented [SW4]: In this section proposed amendments are shown using track changes.

C1: GUIDE TO THE CODE

Paragraph 4 in the section *Guide to the Code* is amended to include reference to Part 2

How the Code is Structured

4. The Code contains the following material:

- Part 1 – *Complying with the Code, Fundamental Principles and Conceptual Framework*, which includes the fundamental principles and the conceptual framework.
- *[~~Part 2 – deleted~~ Amended by the NZAuASB]* Part 2 – *Assurance Practitioners Performing Assurance Services Pursuant to Their Relationship with the firm,* is applicable to individuals who are assurance practitioners when performing professional activities pursuant to their relationship with the firm, whether as a contractor, employee or owner.
- Part 3 – *Application of the Code, Fundamental Principles and Conceptual Framework*, which sets out additional material that applies to assurance practitioners when providing assurance services.
- *International Independence Standards (New Zealand)*, which sets out additional material that applies to assurance practitioners when providing assurance services, as follows:
  - o Part 4A – *Independence for Audit and Review Engagements*, which applies when performing audit or review engagements.
  - o Part 4B – *Independence for Assurance Engagements Other than Audit and Review Engagements*, which applies when performing assurance engagements that are not audit or review engagements.
- *Glossary,* which contains defined terms (together with additional explanations where appropriate) and described terms which have a specific meaning in certain parts of the Code.

…

Commented [SW5]: Wording tailored for NZ situation.

IESBA wording states, "Part 2 – *Professional accountants in business*, which sets out additional material that applies to professional accountants in business when performing professional activities. Professional accountants in business include include professional accountants employed, engaged or contracted in an executive capacity in, for example:

- commerce, industry or service,
- the public sector,
- education,
- the not-for-profit sector,
- regulatory or professional bodes.

Part 2 is also applicable to individuals who are professional accountants in public practice when performing professional activities pursuant to their relationship with the firm, whether as a contractor, employee or owner."

C2: NEW ZEALAND PREFACE

The New Zealand Preface is amended to remove reference to the individual parts of the IESBA Code.

Professional and Ethical Standard 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand),* ("the Code"), issued by the NZAuASB is based on ~~Parts 1, 3, 4A and 4B of~~ the International Code of Ethics for Professional Accountants (including International Independence Standards ("the International Code"). The International Code is issued by the International Ethics Standards Board for Accountants. It is published by the International Federation of Accountants (IFAC) and used with permission of IFAC, as it applies to assurance practitioners in New Zealand.

New Zealand additions and deletions are prefixed with NZ in the Code.

The Code is based on a number of fundamental principles that express the basic tenets of professional and ethical behaviour and conduct. Assurance practitioners must abide by these fundamental principles when performing assurance engagements.

The International Independence Standards (New Zealand) set out requirements that apply to all entities and all assurance practitioners. Small entities and small firms, in certain circumstances, may face difficulties implementing the requirements. Many of the examples provided of actions that might reduce the threat may not be available to small entities and small firms. For example, involving individuals within the firm who are not members of the assurance team in, for example, providing non-assurance services to an assurance client, may not reduce the threats to independence to an acceptable level given the likely closeness of relationships of staff within small firms.

C3: PART 1 – COMPLYING WITH THE CODE, FUNDAMENTAL PRINCIPLES AND CONCEPTUAL FRAMEWORK

Paragraphs 120.3 A1 is amended to include Part 2. Paragraph NZ R120.4.1 is deleted and replaced with R120.4

SECTION 120

THE CONCEPTUAL FRAMEWORK

Introduction

Requirements and Application Material

General

R120.3 The assurance practitioner shall apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles set out in Section 110.

120.3 A1 Additional requirements and application material that are relevant to the application of the conceptual framework are set out in:

(a) Part 2 – *Assurance Practitioners Performing Assurance Services Pursuant to Their Relationship with the Firm;*

~~(a)~~(b)Part 3 – *Application of the Code, Fundamental Principles and Conceptual Framework*; and

~~(b)~~(c)*International Independence Standards (New Zealand)*, as follows:

(i) Part 4A – *Independence for Audit and Review Engagements*; and

(ii) Part 4B – *Independence for Assurance Engagements Other than Audit and Review Engagements*.

R120.4 ~~*[Amended by the NZAuASB. Refer to NZ R120.4.1]*~~When dealing with an ethics issue the assurance practitioner shall consider the context in which the issue has arisen or might arise. Where an individual who is an assurance practitioner is performing professional activities pursuant to the assurance practitioner's relationship with the firm, whether as a contractor, employee or owner, the individual shall comply with the provisions in Part 2 that apply to these circumstances.

~~**NZ R120.4.1** When dealing with an ethics issue, the assurance practitioner shall consider the context in which the issue has arisen or might arise. Where an individual who is an assurance practitioner is performing assurance services pursuant to the assurance practitioner's relationship with the firm, whether as a contractor, employee or owner, the individual shall comply with any other ethical standards that apply to these circumstances.~~

C4: PART 3 – APPLICATION OF THE CODE, FUNDAMENTAL PRINCIPLES AND CONCEPTUAL FRAMEWORK

Paragraph NZ R300.5 is deleted and replaced with R300.5 and paragraph 300.5 A1 is amended to include references to relevant sections in Part 2.

SECTION 300

APPLYING THE CONCEPTUAL FRAMEWORK

Requirements and Application Material

General

R300.4 An assurance practitioner shall comply with the fundamental principles set out in Section 110 and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to compliance with the fundamental principles.

R300.5 ~~*[Deleted by the NZAuASB. Refer to NZ R300.5]*~~ When dealing with an ethics issue, the assurance practitioner shall consider the context in which the issue has arisen or might arise. Where an individual who is an assurance practitioner is performing professional activities pursuant to the assurance practitioner's relationship with the firm, whether as a contractor, employee or owner, the individual shall comply with the provisions in Part 2 that apply to these circumstances.

~~**NZ R300.5** When dealing with an ethics issue, the assurance practitioner shall consider the context in which the issue has arisen or might arise. Where an individual who is an assurance practitioner is performing assurance services pursuant to the assurance practitioner's relationship with the firm, whether as a contractor, employee or owner, the individual shall comply with any other ethical provisions that apply to these circumstances.~~

300.5 A1 Examples of ~~such~~ situations in which the provisions in Part 2 apply to an assurance practitioner include:

- Facing a conflict of interest when being responsible for selecting a vendor for the firm when an immediate family member of the assurance practitioner might benefit financially from the contract. The requirements and application material set out in Section 210 apply in these circumstances.
- Preparing or presenting financial information for the assurance practitioner's client or firm. The requirements and application material set out in Section 220 apply in these circumstances.
- Preparing or presenting financial information for the assurance practitioner's client or firm. The requirements and application material set out in Section 220 apply in these circumstances.
- Being offered an inducement such as being regularly offered complimentary

tickets to attend sporting events by a supplier of the firm. The requirements and application material set out in Section 250 apply in these circumstances.

- Facing pressure from an engagement partner to report chargeable hours inaccurately for a client engagement. The requirements and application material set out in Section 270 apply in these circumstances.

C5: GLOSSARY

Definitions used in Part 2 are added to the Glossary.

In the *International Code of Ethics for Professional Accountants (including International Independence Standards)*, the singular shall be construed as including the plural as well as the reverse, and the terms below have the following meanings assigned to them.

In this Glossary, explanations of defined terms are shown in regular font; italics are used for explanations of described terms which have a specific meaning in certain parts of the Code or for additional explanations of defined terms. References are also provided to terms described in the Code.

Non-compliance with laws and regulations *(assurance practitioners performing assurance services pursuant to their relationship with the firm)*	*Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:* *(a) An assurance practitioner's employing organisation;* *(b) Those charged with governance of the employing organisation;* *(c) Management of the employing organisation; or* *(d) Other individuals working for or under the direction of the employing organisation* *This term is described in paragraph 260.5 A1.*
Non-compliance with laws and regulations *(assurance practitioners)*	*Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:* *(a) A client;* *(b) Those charged with governance of a client;* *(c) Management of a client; or* *(d) Other individuals working for or under the direction of a client.* *This term is described in paragraph 360.5 A1.*
Senior assurance practitioner	*Senior assurance practitioners are directors, offices or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organisation's human, financial, technological, physical and intangible resources.* *This term is described in paragraph 260.11 A1*
Substantial harm	*This term is described in paragraphs 260.5 A3 360.5 A3.*

D: EFFECTIVE DATE

Part 2 will be effective on 15 September 2020.

Early adoption is permitted.

Overview of contextual changes made to the restructured International Code

1. Changes made as a result of the mandate of the NZAuASB:

International Code	PES 1	Comment
professional accountant, professional accountant in public practice, or accountant	assurance practitioner	NZAuASB scope is limited to assurance providers.
public practice	delete	Applies to assurance practitioners only
Employer or employing organization	Deleted in Parts 1, 3 and 4. Retained in Part 2	Relates to Part 2
Part 2 – Professional accountants in Business	Part 2 - Assurance practitioners performing assurance services pursuant to their relationship with the firm	NZAuASB agreed at its December 2019 meeting to incorporate Part 2 in PES 1.
Professional accountant in business	Assurance practitioner	Provisions relating to professional accountants in business are applicable only to assurance practitioners in their role as assurance practitioners. The term PAIB has been amended to assurance practitioner in the context in which Part 2 applies.
professional services (note: professional service is not changed)	assurance services (exceptions 310.9 A2 and R310.10) or when applicable, non-assurance services	Mandate covers assurance work only.
work assignments	assurance engagements	Mandate only covers assurance engagements not all work assignments
work environment	systems and procedures	Mandate restricted to assurance environment
technical and professional standards	standards issued by the External Reporting Board, the New Zealand Auditing and Assurance Standards Board and the New Zealand Accounting Standards Board	Only the XRB standards are binding.
professional	Either professional/assurance practitioner/ individual	As appropriate in the context

2. Other changes:

International Code	Draft PES 1	Comment
listed entity	FMC reporting entity considered to have a higher level of accountability	Defined term
Assurance Framework	Delete or refer to EG Au1	XRB or NZAuASB has not issued the Framework

profession	accountancy profession	More specific
ISQC1	Professional and Ethical Standard 3 (Amended), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements*	Amend international references to refer to NZ standards.

3. NZ spelling changes:

International Code	**Draft PES 1**
behavior	behaviour
inquiry	enquiry
judgment	judgement
skepticism	scepticism
z	s

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	10.1
Meeting date:	12 February 2020
Subject:	IESBA – Objectivity
Date:	29 January 2020
Prepared By:	Sharon Walker

X **Action Required**	☐ **For Information Purposes Only**

Agenda Item Objectives

1. To provide the Board with an update of the proposed revisions to the IESBA Code to address objectivity of the engagement quality reviewer and obtain feedback on proposals for inclusion in a submission.

Background

2. At its December 2019 meeting, the IESBA approved an exposure draft of revisions to the Code to clarify issues relating to the engagement quality reviewer's objectivity. This is in response to comments received on the specific questions raised in the IAASB's Explanatory Memorandum to ED-ISQM 2.

3. The IESBA issued its exposure draft with a 45 day comment period. Submissions are due on 16 March 2020. Accordingly, we are asking the Board to consider the draft proposals and provide feedback with the submission to be approved out of session based on the feedback received.

4. The IAASB is of the view that when an individual is appointed as the engagement quality reviewer immediately after serving as the engagement partner, there are no safeguards or other actions that would eliminate the threats to an individual's objectivity or reduce them to an acceptable level. This view recognises that the engagement quality reviewer is responsible for objectively evaluating the significant judgements made by the engagement team and the conclusions reached thereon. In the case of an audit of financial statements, significant judgements made in prior periods often affect judgements made in subsequent periods, albeit facts and circumstances may change over time. The ability of the engagement quality reviewer to objectively evaluate the significant judgements is affected by previous involvement with those judgements.

5. In its submission to the IAASB on ED-ISQM 2[1], the Board expressed strong views opposing the inclusion of a cooling off period in the IAASB standards. Rather the Board view was that

[1] The NZAUASB's submission on ED-ISQM 2 is available on the XRB website.

the IESBA should consider a cooling off period, in the context of the auditor rotation requirements and, if necessary, address it in the Code. The NZAuASB also noted concerns over the supply pressure the new auditor rotation rules have created in smaller markets.

6. The IESBA proposes to add application material at the end of Section 120 to describe the different types of threat that may be created when an individual is appointed engagement quality reviewer after having served on the audit engagement team, the factors that are relevant in evaluating the level of such threats, and actions that might be safeguards to address the threats.
7. The proposed revisions do not establish a requirement in the IESBA Code for a specific cooling-off period. Rather, the IESBA has determined to leave it to the IAASB to establish in ISQM 2 whether a cooling-off requirement should be introduced.
8. If the Code were to establish a cooling-off requirement, a breach of such a requirement would trigger a breach of the Code, which may call into question the firm's compliance with relevant ethical requirements. The IESBA view is that it would be more appropriate for a breach of such a requirement to be remediated as a quality issue through the firm's system of quality management.
9. The ISQM 2 Task Force is proposing the following requirement in ISQM 2

   The firm's policies or procedures established in accordance with paragraph 16(b) shall address threats to objectivity created by an individual being appointed as an engagement quality reviewer after previously serving as the engagement partner. Such policies and procedures shall specify a cooling off period of two years, or a longer period if required by relevant ethical requirements, before an engagement partner can assume the role of engagement quality reviewer.
10. We support the inclusion of additional application material to address the issue of engagement quality reviewer objectivity. We continue to hold the view that the Code should deal with specific cooling off requirements.

<u>Questions for Board Consideration</u>

- Do you support the proposed guidance addressing the objectivity of an engagement quality reviewer?
- Do you agree with the proposed placement of the proposed guidance in Section 120?
- Do you agree with the IESBA that it would be more appropriate for the IAASB to determine whether a cooling-off requirement should be introduced in proposed ISQM 2 and that the Code should not be prescriptive in this regard?

<u>Action requested</u>

11. We request that the Board consider and provide feedback on the proposed amendments to inform the basis of our submission on the exposure draft when issued.

<u>Material Presented</u>

Agenda item 10.1	Board Meeting Summary Paper
Agenda item 10.2	ED - EQR Objectivity

Exposure Draft
January 2020
Comments due: March 16, 2020

International Ethics Standards Board for Accountants®

Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers

International Ethics Standards Board for Accountants®

About the IESBA

The International Ethics Standards Board for Accountants® (IESBA®) is an independent global standard-setting board. The IESBA's mission is to serve the public interest by setting ethics standards, including auditor independence requirements, which seek to raise the bar for ethical conduct and practice for all professional accountants through a robust, globally operable *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code).

The IESBA believes a single set of high-quality ethics standards enhances the quality and consistency of services provided by professional accountants, thus contributing to public trust and confidence in the accountancy profession. The IESBA sets its standards in the public interest with advice from the IESBA Consultative Advisory Group (CAG) and under the oversight of the Public Interest Oversight Board (PIOB).

The structures and processes that support the operations of the IESBA are facilitated by the International Federation of Accountants® (IFAC®).

REQUEST FOR COMMENTS

This Exposure Draft, *Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers*, was developed and approved by the International Ethics Standards Board for Accountants® (IESBA®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. Comments are requested by **March 16, 2020.**

Respondents are asked to submit their comments electronically through the IESBA website, using the "Submit a Comment" link. Please submit comments in both PDF and Word files. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IESBA prefers that comments are submitted via its website, comments can also be sent to Ken Siong, IESBA Senior Technical Director at KenSiong@ethicsboard.org

This publication may be downloaded from the IESBA website: www.ethicsboard.org. The approved text is published in the English language.

PROPOSED REVISION TO THE CODE ADDRESSING THE OBJECTIVITY OF ENGAGEMENT QUALITY REVIEWERS

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EXPLANATORY MEMORANDUM

I. Introduction

1. This memorandum provides background to, and an explanation of, the proposed addition of application material to Section 120[1] of the Code to address the objectivity of engagement quality reviewers.

2. The IESBA approved this Exposure Draft (ED) in December 2019.

II. Background

3. Some respondents to the International Auditing and Assurance Standards Board's (IAASB's) December 2015 Invitation to Comment, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits*, questioned whether the global auditing or ethics and independence standards should clarify issues relating to an engagement quality control reviewer's[2] (EQCR) objectivity. Specifically, it was pointed out that some jurisdictions require firms to establish mandatory "cooling-off periods" for individuals previously involved in the audit engagement, in particular engagement partners, before they can act in an EQCR role on the same engagement.

4. The IAASB noted that relevant ethical requirements, such as the IESBA Code, may not specifically address threats to objectivity that may arise in these circumstances. For example, a self-review or self-interest threat might be created when judgments made by the individual in the previous engagement continue to influence subsequent periods, as is often the case in an audit of financial statements.

5. The IAASB issued the exposure draft *Proposed International Standard on Quality Management (ISQM) 2, Engagement Quality Reviews* (ED-ISQM 2) in February 2019. Among other matters, the IAASB proposals included changes in terminology from "engagement quality control review" to "engagement quality review" and "engagement quality control reviewer" to "engagement quality reviewer" (EQR).[3] The Explanatory Memorandum (EM) to proposed ISQM 2 included a specific request to respondents for input on whether there is a need for guidance in the proposed ISQM 2 to address the matter of cooling off as an eligibility requirement for the EQR (e.g., where an individual

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[1] Section 120, *The Conceptual Framework*

[2] International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*¸ defines an engagement quality control reviewer as follows:

> A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions it reached in formulating the report.

[3] Proposed ISQM 2 also proposed the following definitions of the terms 'engagement quality review' and 'engagement quality reviewer':

> Engagement quality review: An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.
>
> Engagement quality reviewer: A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

has served previously as an engagement partner on the same engagement), and whether such guidance should be located in proposed ISQM 2 or the Code.

6. Paragraphs 23-28 of the EM to ED-ISQM 2 describe the IAASB discussion and views relating to the eligibility of an individual to be appointed as the EQR immediately after serving as the engagement partner.

Responses to ED-ISQM 2

7. Overall, respondents agreed that the objectivity of the EQR is critical to the effectiveness of the engagement quality review (EQ review). Considering the responses to ED-ISQM 2[4], the general consensus among respondents was that threats to the objectivity of an engagement partner stepping into an EQR role are an important issue that needs to be addressed.

Coordination with the IAASB

8. The IAASB is of the view that when an individual is appointed as the EQR immediately after serving as the engagement partner, the threats to the individual's objectivity are significant. Consequently, the IAASB concluded that a cooling-off period was the most appropriate safeguard. This view recognizes that the EQR is responsible for objectively evaluating the significant judgments made by the engagement team and the conclusions reached thereon. In recurring engagements, the matters on which significant judgements are made may not vary and therefore significant judgments made in prior periods may continue to affect judgements of the engagement team in subsequent periods. The ability of an EQR to perform an objective evaluation of significant judgements is therefore affected when the individual was previously involved with those judgements as the engagement partner. In such circumstances, it is important that appropriate safeguards are put in place to reduce threats to objectivity, in particular the self-review threat, to an acceptable level.

9. Currently, the Code does not explicitly address the issue of the objectivity of the EQR. Following coordination with the IAASB, the IESBA came to the view that it is necessary to address the issue of EQR objectivity holistically in the Code. The IESBA considered that this would be best achieved by having guidance in the Code to explain clearly the application of the conceptual framework when considering the objectivity of the EQR. This guidance would then provide the context for and support any specific provisions the IAASB might determine necessary to promulgate in proposed ISQM 2 to address the specific matter of an individual being appointed to the EQR role after having served on the engagement team (especially in an engagement partner role).

10. Given the IAASB's aim to finalize proposed ISQM 2 by mid-2020, the IESBA therefore decided to start a project on an accelerated basis to develop appropriate guidance in the Code on the topic of EQR objectivity. In progressing this project, the IESBA will continue its close coordination with the IAASB to ensure that the proposed guidance in the Code will be consistent and interoperable with the final ISQM 2.

[4] Refer to IAASB September 2019 Board Meeting Agenda Item 7 Proposed ISQM 2 Issues Final (September 2019) to sight analysis of the ED responses.

III. Significant Matters

A. Application of the Conceptual Framework to Address the Objectivity of an Engagement Quality Reviewer

11. To provide explicit guidance on the application of the conceptual framework to address the topic of the objectivity of an EQR, the IESBA is proposing adding application material at the end of Section 120 (within the subsection dealing with considerations for audits, reviews and other assurance engagements) to explain the different types of threat to compliance with the fundamental principle of objectivity that might be created in circumstances where an individual is being considered for appointment as an EQR for a particular engagement. The IESBA considers that this would help enhance firms' awareness of the range of possible threats to the objectivity of an EQR and assist them in identifying threats given the specific facts and circumstances. (See paragraph 120.14 A2.)

12. The IESBA is also proposing guidance on factors to consider in evaluating the level of the identified threats, as well as actions that might be safeguards to address the threats. (See paragraphs 120.14 A3-A4.)

B. Location and Scope of the Proposed Guidance

13. The IESBA considered different locations in the Code for the proposed guidance. The IESBA did not consider that it would be appropriate to place the guidance in the International Independence Standards as it is addressing the objectivity of the EQR. After considering possible locations in the Code, including in a new standalone section, the IESBA viewed Section 120 as the most appropriate location given that it already deals with separate topics pertinent to audits, reviews and other assurance engagements, i.e., the linkage between independence and the fundamental principles, and professional skepticism.

14. The IESBA considers that adding guidance on the application of the conceptual framework on the topic of EQR objectivity would fit well with the present structure of Section 120. In addition, the guidance is fairly self-contained.

15. The IESBA notes that while the proposed guidance is located within the subsection "Considerations for Audits, Reviews and Other Assurance Engagements" in Section 120, the scope of the guidance is effectively all the engagements for which an EQ review is determined to be an appropriate response to an assessed quality risk(s) under proposed ISQM 1.[5] In finalizing the proposed guidance, the IESBA will ensure that the scope of the guidance aligns with the final ISQM 1.

C. Need for a "Cooling-Off" Period Before an Individual is Appointed to the EQR Role After Having Served on the Engagement

16. The IESBA recognizes the importance of protecting the objectivity of the EQR and therefore considered whether the Code should prescribe a cooling-off period specifically to address the situation where an individual is appointed to an EQR role after having served on the engagement. The IESBA was mindful that a strict prohibition on an individual serving in the EQR role in that situation unless the individual has served a cooling-off period may not be proportionate in certain circumstances. The IESBA took the view that any prohibition or limitation should result from the

[5] Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*.

application of the conceptual framework to the specific facts and circumstances, and that the Code should remain principles-based.

17. After giving the matter due consideration, the IESBA considers that it would be more appropriate for the IAASB to determine whether a cooling-off requirement should be introduced in proposed ISQM 2, following the proposed guidance set out in Section 120, and if so, the circumstances in which the requirement should apply, to whom it should apply, and what the minimum cooling-off period should be.[6] The IESBA considers that this approach is appropriate on the grounds that:

- Under proposed ISQM 1, an EQ review may be performed for a variety of engagements (i.e., not only audits of financial statements, and not only for audits of listed entities), depending on whether the firm determines that an EQ review is an appropriate response to a quality risk. The IESBA considers that it would be more appropriate for the scope of any cooling-off requirement to be specified in the standard that establishes the requirement for an EQ review, i.e., proposed ISQM 1.
- If the Code were to establish a cooling-off requirement, a breach of such a requirement would trigger a breach of the Code, which may call into question the firm's compliance with relevant ethical requirements. The IESBA is of the view that it would be more appropriate for a breach of such a requirement to be remediated as a quality issue through the firm's system of quality management.
- If a cooling-off requirement is to be established, it would be better located together with other eligibility criteria for the EQR in proposed ISQM 2 so that all the relevant material can be found in one place.

IV. Project Timetable and Effective Date

18. The following timetable is planned for this project:

- June 2020 — IESBA consideration of responses to ED and first read of proposed revised text post-exposure
- September 2020 — IESBA approval of revised provisions

19. Subject to meeting the above timetable, the IESBA proposes that the effective date of the proposed guidance in Section 120 be aligned with the proposed effective date of ISQM 2.

V. Guide for Respondents

20. The IESBA welcomes comments on all matters addressed in this ED, but especially those identified in the Request for Specific Comments below. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in this ED, it will be helpful for the IESBA to be made aware of this view.

[6] The February 2019 Exposure Draft of proposed ISQM 2, paragraph A5, included guidance stating that in the case of an audit of financial statements of a listed entity, it is unlikely that an engagement partner would be able to act as the engagement quality reviewer until two subsequent audits have been conducted.

Request for Specific Comments

21. The IESBA welcomes views from respondents on the following matters.

1.	Do you support the proposed guidance addressing the topic of the objectivity of an EQR?
2.	If so, do you support the location of the proposed guidance in Section 120 of the Code?
3.	Do you agree with the IESBA that it would be more appropriate for the IAASB to determine whether a cooling-off requirement should be introduced in proposed ISQM 2 as discussed in Section III.C above, and that the Code should not be prescriptive in this regard?

Request for General Comments

22. In addition to the request for specific comments above, the IESBA is also seeking comments on the matters set out below:

(a) *Regulators and Audit Oversight Bodies* – The IESBA invites comments on the proposed guidance from an enforcement perspective from members of the regulatory and audit oversight communities.

(b) *Small and Medium Practices (SMPs)* – The IESBA invites comments regarding the impact of the proposed guidance for SMPs.

(c) *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposed guidance, and in particular, on any foreseeable difficulties in applying it in their environment.

(d) *Translations*—Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposed guidance.

EXPOSURE DRAFT: PROPOSED REVISION TO THE CODE ADDRESSING THE OBJECTIVITY OF ENGAGEMENT QUALITY REVIEWERS

SECTION 120

THE CONCEPTUAL FRAMEWORK

Considerations for Audits, Reviews and Other Assurance Engagements

…

Engagement Quality Reviews

120.14 A1 Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. [Proposed] ISQM 1 establishes a firm's responsibilities for its system of quality management and requires the firm to design and implement responses to assessed quality risks related to engagement performance. Such responses include establishing policies or procedures addressing engagement quality reviews in accordance with ISQM 2.

120.14 A2 Threats to compliance with the fundamental principle of objectivity might be created in certain circumstances in which a professional accountant is appointed as the engagement quality reviewer. The following are examples of threat that might be created:

(a) Self-interest threat

- Two engagement partners who serve as an engagement quality reviewer for each other's engagement.

(b) Self-review threat

- The accountant serves as an engagement quality reviewer on an audit engagement after serving as the engagement partner or other engagement team member.

(c) Familiarity threat

- The accountant who serves as engagement quality reviewer has a long association or close relationship with, or is an immediate family member of, an audit team member.

(d) Intimidation threat

- The accountant who serves as engagement quality reviewer for an audit engagement also has a direct reporting line to the engagement partner.

120.14 A3 Factors that are relevant in evaluating the level of such threats include:

- The role and seniority of the professional accountant.
- The length of time since the accountant was last a member of the engagement team prior to being appointed as engagement quality reviewer.
- The nature and complexity of issues that required significant judgment from the accountant when previously a member of the engagement team.

120.14 A4 Examples of safeguards or actions that might address such threats include:

- Implementing a period of sufficient duration (a cooling-off period) before the professional accountant is appointed as engagement quality reviewer.
- Having an appropriate reviewer review specific areas of significant judgment.
- Reassigning reporting responsibilities within the firm.

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NZ AUDITING AND ASSURANCE STANDARDS BOARD

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO.	11.1
Meeting date:	12 February 2020
Subject:	Revisions to Part 4B of the Code
Date:	29 January 2020
Prepared by:	Sharon Walker

X	**Action Required**		**For Information Purposes Only**

Agenda Item Objectives

1. The objective for this agenda item is for the Board to:

   - to APPROVE Amendments to Professional and Ethical Standard 1: Part 4B – Independence for Assurance Engagements Other Than Audit and Review Engagements; and
   - APPROVE the signing memorandum.

Background

2. Part 4B of the Code comprises the independence standards for assurance engagements other than audit engagements and review engagements, as defined in the Code.

3. In March 2019, the IESBA approved proposed revised Part 4B of the Code (the "Part 4B ED") for exposure. The changes align Part 4B to assurance terms and concepts used in ISAE 3000 (Revised).

4. The main revisions, developed in coordination with the IAASB, include:

   - Changes in key terminology, including a revised definition of the term "assurance client";
   - Amendments to certain independence requirements in light of the revised assurance client definition;
   - Greater clarity as to the parties to an assurance engagement and their roles and responsibilities, and the related independence requirements that apply; and
   - A clearer distinction between the types of assurance engagements covered in Parts 4A (addressing independence for audit and review engagements) and 4B of the Code.

5. The comment period for the Part 4B ED closed on 26 June 2019. Twenty-six comment letters were received from various respondents, including regulators, oversight bodies, national standard setters (including the NZAuASB[1]), accounting firms, IFAC member bodies and other professional organisations.

6. The IESBA Basis for Conclusions explains the more significant issues raised by respondents to the Part 4B ED, and how the IESBA addressed them.

7. The revisions to Part 4B of the Code were approved by the IESBA in September 2019 with the unanimous approval of IESBA members. The final standard was issued in January 2020.

8. Part 4B relating to independence for assurance engagements with respect to underlying subject matter covering periods will be effective for periods beginning on or after 15 June 2021; otherwise it will be effective as of 15 June 2021. Early adoption will be permitted.

Australia

9. The APESB staff have not yet started looking at the changes to Part 4B of the Code. It is anticipated that the APESB will consider revisions to Part 4B at their meeting in June 2020.

Disposition of NZ Comments

10. The comments made by the NZAuASB in its submission and their disposition by the IESBA are addressed in the following paragraphs. For those comments where the IESBA did not agree or action our point we do not consider that the issue is critical and therefore do not consider that there is a compelling reason to modify the IESBA standard.

Definition of an Assurance Client

11. The NZAuASB expressed concern that the definition of the term "assurance client" may be too restrictive. The proposed definition of assurance client included only the responsible party and, where applicable, the party taking responsibility for the subject matter information. The submission notes that ISAE 3000 (Revised) envisages circumstances where other influential parties might be involved in an assurance engagement.

12. In its basis for conclusions the IESBA notes that most respondents supported the term assurance client as defined. Accordingly, no change was made to the definition. Additional guidance was added to clarify the application of the Code to other parties.

[1] The NZAuASB submission is available on the XRB website.

Changes to the Independence Requirements

13. The NZAuASB expressed a concern that it might be inappropriate to refer to parties other than intended users of an assurance report as "clients". In an assurance engagement the ultimate objective of the professional accountant is to address the needs and interests of the intended users/beneficiaries of their reports. Referring to parties other than the intended users of the assurance report as "clients" may inadvertently affect the mindset of the professional accountant in a manner inconsistent with the objectives of an assurance engagement.
14. The IESBA noted the general level of support for the term 'assurance client', which provides a convenient basis of comparison with Part 4A and is simple to read in Part 4B. The term is consistent with the principles of ISAE 3000 (Revised) and is the equivalent of the term audit client used in Part 4A. For these reasons, the IESBA determined that use of the term 'assurance client' is appropriate in Part 4B.
15. The IESBA concluded that it is important for the user of the Code to understand the requirement for the firm to be independent of the assurance client and that this might be more than one party. The IESBA reaffirmed that the different wording in paragraph R900.11[2] from the equivalent paragraph in Part 4A[3] is justified because, in an assurance engagement, it is not intuitively clear from which entity, or entities, the firm is required to be independent.
16. In the case of an assurance engagement, the existence of additional parties other than the responsible party and the party taking responsibility for the subject matter information might make the process of determining how the Code is to be applied more complicated than, for example, in the case of an audit. In the case of additional parties, the conceptual framework applies in considering the interests and relationships which might affect objectivity. Additional guidance has been included to this effect in light of the responses received. (Refer paragraph 900.11 A3)
17. The IESBA is of the view that it is more common in an attestation engagement for the same party to be responsible for both the underlying subject matter and the subject matter information. It does not believe that the changes in the independence requirements represent a significant change in the application of the Code.

Split of assurance engagements between Part 4A and 4B

18. In its submission, the NZAuASB questioned the classification of audits of specific elements, accounts or items of a financial statement which are conducted under ISA 805 (Revised) as other assurance engagements in the Code.

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[2] Paragraph R900.11, A firm performing an assurance engagement shall be independent of the assurance client.

[3] Part 4A, R400.11, A firm performing an audit or review engagement shall be independent.

19. In its basis for conclusions, the IESBA reiterated that for purposes of the Code, ‘assurance engagements’ extend beyond engagements covered by International Standards on Assurance Engagements and include audits of specific elements, accounts or items of a financial statement which are conducted under ISA 805 (Revised).

20. Although audits of specific elements, accounts or items of a financial statement are audit engagements under IAASB standards, they are not audit engagements as defined in the glossary to the Code because they do not relate to financial statements as defined in the glossary. This does not represent a change to the extant Code. The IESBA has clarified the intent of the Code and provided additional examples (see paragraph 900.1 and glossary definition of ‘financial statements’).

<u>NZ paragraphs in Extant Part 4B</u>

21. Extant Part 4B contains the following NZ paragraphs which have been retained as NZ paragraphs in the amending standard:

    - “Where an assurance practitioner identifies multiple threats to independence which individually may not be significant, the assurance practitioner shall evaluate the significance of those threats in aggregate and apply safeguards to eliminate or reduce them to an acceptable level in aggregate.” (see paragraph NZ R900.12.1)
      In the IESBA code, the discussion about threats to independence, including multiple threats, is contained in section 120. The reference in the IESBA Code to multiple threats is not as detailed as the NZ paragraph.

    - As required by R120.10, where the threat cannot be eliminated or safeguards, where available and capable of being applied, cannot reduce the threat to an acceptable level, the firm shall end or decline the engagement. (see paragraph NZ R905.3.1)

      The NZ paragraph adds emphasis that where the threat of receiving a large proportion of total fees from one client cannot be eliminated or reduced to an acceptable level, the assurance practitioner shall decline or withdraw. This action is required by the conceptual framework.

<u>NZ Definition of Assurance Client</u>

22. The definition of assurance client in PES 1 differs from that of the IESBA Code. The IESBA Code defines assurance client as:

    > The responsible party and also, in an attestation engagement, the party taking responsibility for the subject matter information (who might be the same as the responsible party).

23. PES 1 defines assurance client as:

An entity in respect of which a firm conducts an assurance engagement.

24. The IESBA Code recognises that in the majority of attestation engagements, the responsible party and the party taking responsibility for the subject matter information will be the same.

25. Scenarios where the responsible party and the party taking responsibility for the subject matter information include (examples provided by IESBA staff):

   - the responsible party appoints another party to be measurer/evaluator might be where the responsible party has gathered raw data regarding its carbon emissions, but does not have the expertise to evaluate that data and present it according to the requirements of relevant environmental standards. It might therefore engage a third party specialist either to perform and take full responsibility for the evaluation or to provide professional advice to the responsible party on the basis that the responsible party will also take responsibility for the evaluation. In the first situation, the environmental specialist would be responsible for the measurement/evaluation and in the second situation, the responsible party would be responsible for the measurement/evaluation.

   - a regulator (for example) would be the engaging party and might require a third party, independent of the responsible party, to perform an evaluation of the subject matter in accordance with the requirements of the regulator, and to take responsibility for that exercise. It is of course possible (and maybe even more likely) that in this situation that third party would also be required to provide assurance to the regulator. If this were the case then this would be a direct assurance engagement. However, it is also possible that another party, for example a professional accountant, would provide the assurance on the work of the party appointed to perform the measurement/evaluation. In this situation, the professional accountant would need to be independent both of the responsible party and the party responsible for the measurement/evaluation.

26. While the revised IESBA definition of assurance client, as described in paragraph 22, is clearer than the extant definition, it is still not easy read and understand. The IESBA definition does, however, make it clear that there might be more than one party that is the assurance client, i.e., the responsible party (responsible for the underlying subject matter) and the party taking responsibility for the subject matter information. Further, it is supported by the application material in paragraphs 900.11 A1 – 900.11 A3 (refer agenda item xx).

27. The NZ definition of assurance client is simple and user-friendly and aligns with the definition of audit client.

28. The NZAuASB's principles of convergence to international standards require that the international standard should be used as a base for the New Zealand standard and should only be amended if there are compelling reasons to do so. While the NZ definition of assurance client is simple and user-friendly, and aligns with the definition of audit client, it is not clear that the modification would meet the compelling reason test. Further, it is not clear that the NZ definition (see paragraph 23) captures both the responsible party and the party taking responsibility for the subject matter information, where these are different. We recommend that the Board adopt the IESBA definition.

29. Questions for Board consideration:

- Does the Board envisage any unintended consequences from adopting the IESBA definition?

- Do you consider that there is a compelling reason to have a different definition of assurance client in NZ?

<u>Matters to Consider</u>

30. The Board is asked to CONSIDER and APPROVE Amendments to PES 1: Part 4B – Independence for Assurance Engagements Other Than Audit and Review Engagements.

31. The amendments to PES 1 will be gazetted once approved by the Board.

32. The Financial Reporting Act 2013, section 22(2) requires that the External Reporting Board consult with the Privacy Commissioner where an accounting or assurance standard is likely to require the disclosures of personal information. No such consultation is required in relation to this standard.

<u>Material Presented</u>

Agenda item 11.1	Board Meeting Summary Paper
Agenda item 11.2	Amendments to PES 1 Part 4B (clean for approval)
Agenda item 11.3	Amendments to PES 1 Part 4B (mark up for consideration)
Agenda item 11.4	Draft signing memorandum (for approval)

EXTERNAL REPORTING BOARD

Te Kāwai Ārahi Pūrongo Mōwaho

NZ AUDITING AND ASSURANCE STANDARDS BOARD

AMENDMENTS TO PROFESSIONAL AND ETHICAL STANDARD 1: PART 4B -- INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

This Standard was issued on 1 March 2020 by the New Zealand Auditing and Assurance Standards Board of the External Reporting Board pursuant to section 12(b) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 28 March 2020.

An assurance practitioner that is required to apply this Standard is required to apply it to underlying subject matter covering periods for periods beginning on or after 15 June 2021; otherwise, it will be effective on 15 June 2021. Early adoption will be permitted.

In finalising this Standard, the New Zealand Auditing and Assurance Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Standard has been issued as a result of revision of Part 4B of the International Code of Ethics for Professional Accountants, including International Independence Standards by the International Ethics Standards Board for Accountants.

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AMENDMENTS TO PROFESSIONAL AND ETHICAL STANDARD 1: PART 4B, INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

CONTENTS

A: INTRODUCTION

This document sets out amendments to Professional and Ethical Standard (PES) *1 International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*. These amendments have been issued as a result of changes made to the International Code of Ethics for Professional Accountants issued by IESBA.

Section B of this document sets out amendments to Part 4B, *Independence for Assurance Engagements Other Than Audit and Review Engagements,* of PES 1. New text is underlined and deleted text is struck through.

B: AMENDMENTS TO PART 4B – INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

PART 4B – INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

SECTION 900

APPLYING THE CONCEPTUAL FRAMEWORK TO INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

Introduction

General

900.1 This Part applies to assurance engagements other than audit engagements and review engagements. Examples of such engagements include:

- Assurance on an entity's key performance indicators.
- Assurance on an entity's compliance with law or regulation.
- Assurance on performance criteria, such as value for money, achieved by a public sector body.
- Assurance on the effectiveness of an entity's system of internal control.
- Assurance on an entity's greenhouse gas statement.
- An audit of specific elements, accounts or items of a financial statement.

900.2 In this Part, the term "assurance practitioner" refers to individual assurance practitioners and their firms.

900.3 Professional and Ethical Standard 3 (Amended), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements,* requires a firm to establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements maintain independence where required by relevant ethics standards. In addition, International Standards on Assurance Engagements (New Zealand), Standards on Assurance Engagements and International Standards on Auditing (New Zealand) establish responsibilities for engagement partners and engagement teams at the level of the engagement. The allocation of responsibilities within a firm will depend on its size, structure and organisation. Many of the provisions of Part 4B do not prescribe the specific responsibility of individuals within the firm for actions related to independence, instead referring to "firm" for ease of reference. Firms assign responsibility for a particular action to an individual or a group of individuals (such as an assurance team) in accordance with Professional and Ethical Standard 3 (Amended). Additionally, an individual assurance practitioner remains responsible for compliance with any provisions that apply to that assurance practitioner's activities, interests or relationships.

900.4 Independence is linked to the principles of objectivity and integrity. It comprises:

(a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, thereby allowing an individual to act with integrity, and exercise objectivity and professional scepticism.

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's or an assurance team member's integrity, objectivity or professional scepticism has been compromised.

In this Part, references to an individual or firm being "independent" mean that the individual or firm has complied with the provisions of this Part.

900.5 When performing assurance engagements, the Code requires firms to comply with the fundamental principles and be independent. This Part sets out specific requirements and application material on how to apply the conceptual framework to maintain independence when performing assurance engagements other than audit or review engagements. The conceptual framework set out in Section 120 applies to independence as it does to the fundamental principles set out in Section 110.

900.6 This Part describes:

(a) Facts and circumstances, including professional activities, interests and relationships, that create or might create threats to independence;

(b) Potential actions, including safeguards, that might be appropriate to address any such threats; and

(c) Some situations where the threats cannot be eliminated or there can be no safeguards to reduce the threats to an acceptable level.

Description of Assurance Engagements

900.7 In an assurance engagement, the firm aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users (other than the responsible party) about the subject matter information. ISAE (NZ) 3000 (Revised) describes the elements and objectives of an assurance engagement conducted under that Standard, and Explanatory Guide (EG) Au1A, *Framework for Assurance Engagements*, provides a general description of assurance engagements. An assurance engagement might either be an attestation engagement or a direct engagement.

900.8 In this Part, the term 'assurance engagement' refers to assurance engagements other than audit engagements or review engagements.

Reports that Include a Restriction on Use and Distribution

900.9 An assurance report might include a restriction on use and distribution. If it does and the conditions set out in Section 990 are met, then the independence requirements in this Part may be modified as provided in Section 990.

Audit and Review Engagements

900.10 Independence standards for audit and review engagements are set out in Part 4A – *Independence for Audit and Review Engagements*. If a firm performs both an assurance engagement and an audit or review engagement for the same client, the requirements in Part 4A continue to apply to the firm, a network firm and the audit or review team members.

NZ 900.10.1 Part 4A also addresses the independence requirements for assurance engagements where assurance is provided in relation to an offer document of a FMC reporting entity considered to have a higher level of public accountability in respect of historical financial information, prospective or pro-forma financial information, or a combination of these.

Requirements and Application Material

General

R900.11 A firm performing an assurance engagement shall be independent of the assurance client.

900.11 A1 For the purposes of this Part, the assurance client in an assurance engagement is the responsible party and also, in an attestation engagement, the party taking responsibility for the subject matter information (who might be the same as the responsible party).

900.11 A2 The roles of the parties involved in an assurance engagement might differ and affect the application of the independence provisions in this Part. In the majority of attestation engagements, the responsible party and the party taking responsibility for the subject matter information are the same. This includes those circumstances where the responsible party involves another party to measure or evaluate the underlying subject matter against the criteria (the measurer or evaluator) where the responsible party takes responsibility for the subject matter information as well as the underlying subject matter. However, the responsible party or the engaging party might appoint another party to prepare the subject matter information. In this circumstance, the responsible party and that party responsible for the subject matter information are both assurance clients for the purposes of this Part.

900.11 A3 In addition to the responsible party and, in an attestation engagement, the party taking responsibility for the subject matter information, there might be other parties in relation to the engagement. For example, there might be a separate engaging party or a party who is a measurer or evaluator other than the party taking responsibility for the subject matter information. In these circumstances, applying the conceptual framework requires the professional accountant to identify and evaluate threats to the fundamental principles created by any interests or relationships with such parties, including whether any conflicts of interest might exist as described in Section 310.

R900.12 A firm shall apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence in relation to an assurance engagement.

NZ R900.12.1 Where an assurance practitioner identifies multiple threats to independence, which individually may not be significant, the assurance practitioner shall evaluate the significance of those threats in aggregate and apply safeguards to eliminate or reduce them to an acceptable level in aggregate.

Multiple Responsible Parties and Parties Taking Responsibility for the Subject Matter Information

900.13 A1 In some assurance engagements, whether an attestation engagement or direct engagement, there might be several responsible parties or, in an attestation engagement, several parties taking responsibility for the subject matter information. In determining whether it is necessary to apply the provisions in this Part to each individual responsible party or each individual party taking responsibility for the subject matter information in such engagements, the firm may take into account certain matters. These matters include whether an interest or relationship between the firm, or an assurance team member, and a particular responsible party or party taking responsibility for the subject matter information would create a threat to independence that is not trivial and inconsequential in the context of the subject matter information. This determination will take into account factors such as:

(a) The materiality of the underlying subject matter or subject matter information for which the particular party is responsible in the context of the overall assurance engagement.
(b) The degree of public interest associated with the assurance engagement.

If the firm determines that the threat created by any such interest or relationship with a particular party would be trivial and inconsequential, it might not be necessary to apply all of the provisions of that section to that party.

Network Firms

R900.14 When a firm knows or has reason to believe that interests and relationships of a network firm create a threat to the firm's independence, the firm shall evaluate and address any such threat.

900.14 A1 Network firms are discussed in paragraphs 400.50 A1 to 400.54 A1.

Related Entities

R900.15 When the assurance team knows or has reason to believe that a relationship or circumstance involving a related entity of the assurance client is relevant to the evaluation of the firm's independence from the client, the assurance team shall include that related entity when identifying, evaluating and addressing threats to independence.

[Paragraphs 900.16 to 900.29 are intentionally left blank]

Period During which Independence is Required

R900.30 Independence, as required by this Part, shall be maintained during both:

(a) The engagement period; and

(b) The period covered by the subject matter information.

900.30 A1 The engagement period starts when the assurance team begins to perform assurance services with respect to the particular engagement. The engagement period ends when the assurance report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final assurance report.

R900.31 If an entity becomes an assurance client during or after the period covered by the subject matter information on which the firm will express a conclusion, the firm shall determine whether any threats to independence are created by:

(a) Financial or business relationships with the assurance client during or after the period covered by the subject matter information but before accepting the assurance engagement; or

(b) Previous services provided to the assurance client.

R900.32 Threats to independence are created if a non-assurance service was provided to the assurance client during, or after the period covered by the subject matter information, but before the assurance team begins to perform assurance services, and the service would not be permitted during the engagement period. In such circumstances, the firm shall evaluate and address any threat to independence created by the service. If the threats are not at an acceptable level, the firm shall only accept the assurance engagement if the threats are reduced to an acceptable level.

900.32 A1 Examples of actions that might be safeguards to address such threats include:

- Using professionals who are not assurance team members to perform the service.
- Having an appropriate reviewer review the assurance and non-assurance work as appropriate.

R900.33 If a non-assurance service that would not be permitted during the engagement period has not been completed and it is not practical to complete or end the service before the commencement of professional services in connection with the assurance engagement, the firm shall only accept the assurance engagement if:

(a) The firm is satisfied that:

  (i) The non-assurance service will be completed within a short period of time; or

  (ii) The client has arrangements in place to transition the service to another provider within a short period of time;

(b) The firm applies safeguards when necessary during the service period; and

(c) The firm discusses the matter with those charged with governance.

[Paragraphs 900.34 to 900.39 are intentionally left blank]

General Documentation of Independence for Assurance Engagements

R900.40 A firm shall document conclusions regarding compliance with this Part, and the substance of any relevant discussions that support those conclusions. In particular:

(a) When safeguards are applied to address a threat, the firm shall document the nature of the threat and the safeguards in place or applied; and

(b) When a threat required significant analysis and the firm concluded that the threat was already at an acceptable level, the firm shall document the nature of the threat and the rationale for the conclusion.

900.40 A1 Documentation provides evidence of the firm's judgements in forming conclusions regarding compliance with this Part. However, a lack of documentation does not determine whether a firm considered a particular matter or whether the firm is independent.

[Paragraphs 900.41 to 900.49 are intentionally left blank]

Breach of an Independence Provision for Assurance Engagements

When a Firm Identifies a Breach

R900.50 If a firm concludes that a breach of a requirement in this Part has occurred, the firm shall:

(a) End, suspend or eliminate the interest or relationship that created the breach;

(b) Evaluate the significance of the breach and its impact on the firm's objectivity and ability to issue an assurance report; and

(c) Determine whether action can be taken that satisfactorily addresses the consequences of the breach.

In making this determination, the firm shall exercise professional judgement and take into account whether a reasonable and informed third party would be likely to conclude that the firm's objectivity would be compromised, and therefore, the firm would be unable to issue an assurance report.

R900.51 If the firm determines that action cannot be taken to address the consequences of the breach satisfactorily, the firm shall, as soon as possible, inform the party that engaged the firm or those charged with governance, as appropriate. The firm shall also take the steps necessary to end the assurance engagement in compliance with any applicable legal or regulatory requirements relevant to ending the assurance engagement.

R900.52 If the firm determines that action can be taken to address the consequences of the breach satisfactorily, the firm shall discuss the breach and the action it has taken or proposes to take with the party that engaged the firm or those charged with governance, as appropriate. The firm shall discuss the breach and the proposed action on a timely basis, taking into account the circumstances of the engagement and the breach.

R900.53 If the party that engaged the firm does not, or those charged with governance do not concur that the action proposed by the firm in accordance with paragraph R900.50(c) satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to end the assurance engagement in compliance with any applicable legal or regulatory requirements relevant to ending the assurance engagement.

Documentation

R900.54 In complying with the requirements in paragraphs R900.50 to R900.53, the firm shall document:

(a) The breach;

(b) The actions taken;

(c) The key decisions made; and

(d) All the matters discussed with the party that engaged the firm or those charged with governance.

R900.55 If the firm continues with the assurance engagement, it shall document:

(a) The conclusion that, in the firm's professional judgement, objectivity has not been compromised; and

(b) The rationale for why the action taken satisfactorily addressed the consequences of the breach so that the firm could issue an assurance report.

SECTION 905

FEES

Introduction

905.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

905.2 The nature and level of fees or other types of remuneration might create a self-interest or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Fees—Relative Size

NZ R905.3.1 As required by R120.10, where the threat cannot be eliminated or safeguards, where available and capable of being applied, cannot reduce the threat to an acceptable level, the firm shall end or decline the engagement.

905.3 A1 When the total fees generated from an assurance client by the firm expressing the conclusion in an assurance engagement represent a large proportion of the total fees of that firm, the dependence on that client and concern about losing the client create a self-interest or intimidation threat.

905.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The operating structure of the firm.
- Whether the firm is well established or new.
- The significance of the client qualitatively and/or quantitatively to the firm.

905.3 A3 An example of an action that might be a safeguard to address such a self-interest or intimidation threat is increasing the client base in the firm to reduce dependence on the assurance client.

905.3 A4 A self-interest or intimidation threat is also created when the fees generated by the firm from an assurance client represent a large proportion of the revenue from an individual partner's clients.

905.3 A5 Examples of actions that might be safeguards to address such a self-interest or intimidation threat include:

- Increasing the client base of the partner to reduce dependence on the assurance client.
- Having an appropriate reviewer who was not an assurance team member review the work.

Fees—Overdue

905.4 A1 A self-interest threat might be created if a significant part of fees is not paid before the assurance report, if any, for the following period is issued. It is generally expected that the firm will require payment of such fees before any such report is issued. The requirements and application material set out in Section 911 with respect to loans and guarantees might also apply to situations where such unpaid fees exist.

905.4 A2 Examples of actions that might be safeguards to address such a self-interest threat include:

- Obtaining partial payment of overdue fees.
- Having an appropriate reviewer who did not take part in the assurance engagement review the work performed.

R905.5 When a significant part of fees due from an assurance client remains unpaid for a long time, the firm shall determine:

(a) Whether the overdue fees might be equivalent to a loan to the client; and

(b) Whether it is appropriate for the firm to be re-appointed or continue the assurance engagement.

Contingent Fees

905.6 A1 Contingent fees are fees calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed. A contingent fee charged through an intermediary is an example of an indirect contingent fee. In this section, a fee is not regarded as being contingent if established by a court or other public authority.

R905.7 A firm shall not charge directly or indirectly a contingent fee for an assurance engagement.

R905.8 A firm shall not charge directly or indirectly a contingent fee for a non-assurance service provided to an assurance client if the outcome of the non-assurance service, and therefore, the amount of the fee, is dependent on a future or contemporary judgement related to a matter that is material to the subject matter information of the assurance engagement.

905.9 A1 Paragraphs R905.7 and R905.8 preclude a firm from entering into certain contingent fee arrangements with an assurance client. Even if a contingent fee arrangement is not precluded when providing a non-assurance service to an assurance client, a self-interest threat might still be created.

905.9 A2 Factors that are relevant in evaluating the level of such a threat include:

- The range of possible fee amounts.
- Whether an appropriate authority determines the outcome on which the contingent fee depends.
- Disclosure to intended users of the work performed by the firm and the basis of remuneration.
- The nature of the service.
- The effect of the event or transaction on the subject matter information.

905.9 A3 Examples of actions that might be safeguards to address such a self-interest threat include:

- Having an appropriate reviewer who was not involved in performing the non-assurance service review the relevant assurance work.
- Obtaining an advance written agreement with the client on the basis of remuneration.

SECTION 906

GIFTS AND HOSPITALITY

Introduction

906.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

906.2 Accepting gifts and hospitality from an assurance client might create a self-interest, familiarity or intimidation threat. This section sets out a specific requirement and application material relevant to applying the conceptual framework in such circumstances.

Requirement and Application Material

R906.3 A firm or an assurance team member shall not accept gifts and hospitality from an assurance client, unless the value is trivial and inconsequential.

906.3 A1 Where a firm or assurance team member is offering or accepting an inducement to or from an assurance client, the requirements and application material set out in Section 340 apply and non-compliance with these requirements might create threats to independence.

906.3 A2 The requirements set out in Section 340 relating to offering or accepting inducements do not allow a firm or assurance team member to accept gifts and hospitality where the intent is to improperly influence behaviour even if the value is trivial and inconsequential.

SECTION 907

ACTUAL OR THREATENED LITIGATION

Introduction

907.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

907.2 When litigation with an assurance client occurs, or appears likely, self-interest and intimidation threats are created. This section sets out specific application material relevant to applying the conceptual framework in such circumstances.

Application Material

General

907.3 A1 The relationship between client management and assurance team members must be characterised by complete candor and full disclosure regarding all aspects of a client's operations. Adversarial positions might result from actual or threatened litigation between an assurance client and the firm or an assurance team member. Such adversarial positions might affect management's willingness to make complete disclosures and create self-interest and intimidation threats.

907.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The materiality of the litigation.
- Whether the litigation relates to a prior assurance engagement.

907.3 A3 If the litigation involves an assurance team member, an example of an action that might eliminate such self-interest and intimidation threats is removing that individual from the assurance team.

907.3 A4 An example of an action that might be a safeguard to address such self-interest and intimidation threats is having an appropriate reviewer review the work performed.

SECTION 910

FINANCIAL INTERESTS

Introduction

910.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

910.2 Holding a financial interest in an assurance client might create a self-interest threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

910.3 A1 A financial interest might be held directly or indirectly through an intermediary such as a collective investment vehicle, an estate or a trust. When a beneficial owner has control over the intermediary or ability to influence its investment decisions, the Code defines that financial interest to be direct. Conversely, when a beneficial owner has no control over the intermediary or ability to influence its investment decisions, the Code defines that financial interest to be indirect.

910.3 A2 This section contains references to the “materiality” of a financial interest. In determining whether such an interest is material to an individual, the combined net worth of the individual and the individual’s immediate family members may be taken into account.

910.3 A3 Factors that are relevant in evaluating the level of a self-interest threat created by holding a financial interest in an assurance client include:

- The role of the individual holding the financial interest.
- Whether the financial interest is direct or indirect.
- The materiality of the financial interest.

Financial Interests Held by the Firm, Assurance Team Members and Immediate Family

R910.4 A direct financial interest or a material indirect financial interest in the assurance client shall not be held by:

(a) The firm; or

(b) An assurance team member or any of that individual’s immediate family.

Financial Interests in an Entity Controlling an Assurance Client

R910.5 When an entity has a controlling interest in the assurance client and the client is material to the entity, neither the firm, nor an assurance team member, nor any of that individual’s immediate family shall hold a direct or material indirect financial interest in that entity.

Financial Interests Held as Trustee

R910.6 Paragraph R910.4 shall also apply to a financial interest in an assurance client held in a trust for which the firm or individual acts as trustee unless:

(a) None of the following is a beneficiary of the trust: the trustee, the assurance team member or any of that individual's immediate family, or the firm;

(b) The interest in the assurance client held by the trust is not material to the trust;

(c) The trust is not able to exercise significant influence over the assurance client; and

(d) None of the following can significantly influence any investment decision involving a financial interest in the assurance client: the trustee, the assurance team member or any of that individual's immediate family, or the firm.

Financial Interests Received Unintentionally

R910.7 If a firm, an assurance team member, or any of that individual's immediate family, receives a direct financial interest or a material indirect financial interest in an assurance client by way of an inheritance, gift, as a result of a merger, or in similar circumstances and the interest would not otherwise be permitted to be held under this section, then:

(a) If the interest is received by the firm, the financial interest shall be disposed of immediately, or enough of an indirect financial interest shall be disposed of so that the remaining interest is no longer material; or

(b) If the interest is received by an assurance team member, or by any of that individual's immediate family, the individual who received the financial interest shall immediately dispose of the financial interest, or dispose of enough of an indirect financial interest so that the remaining interest is no longer material.

Financial Interests – Other Circumstances

Close Family

910.8 A1 A self-interest threat might be created if an assurance team member knows that a close family member has a direct financial interest or a material indirect financial interest in the assurance client.

910.8 A2 Factors that are relevant in evaluating the level of such a threat include:

- The nature of the relationship between the assurance team member and the close family member.
- Whether the financial interest is direct or indirect.
- The materiality of the financial interest to the close family member.

910.8 A3 Examples of actions that might eliminate such a self-interest threat include:

- Having the close family member dispose, as soon as practicable, of all of the financial interest or dispose of enough of an indirect financial interest so that the remaining interest is no longer material.

- Removing the individual from the assurance team.

910.8 A4 An example of an action that might be a safeguard to address such a self-interest threat is having an appropriate reviewer review the work of the assurance team member.

Other Individuals

910.8 A5 A self-interest threat might be created if an assurance team member knows that a financial interest is held in the assurance client by individuals such as:

- Partners and professional employees of the firm, apart from those who are specifically not permitted to hold such financial interests by paragraph R910.4, or their immediate family members.
- Individuals with a close personal relationship with an assurance team member.

910.8 A6 An example of an action that might eliminate such a self-interest threat is removing the assurance team member with the personal relationship from the assurance team.

910.8 A7 Examples of actions that might be safeguards to address such a self-interest threat include:

- Excluding the assurance team member from any significant decision-making concerning the assurance engagement.
- Having an appropriate reviewer review the work of the assurance team member.

SECTION 911

LOANS AND GUARANTEES

Introduction

911.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

911.2 A loan or a guarantee of a loan with an assurance client might create a self-interest threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

911.3 A1 This section contains references to the "materiality" of a loan or guarantee. In determining whether such a loan or guarantee is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

Loans and Guarantees with an Assurance Client

R911.4 A firm, an assurance team member, or any of that individual's immediate family shall not make or guarantee a loan to an assurance client unless the loan or guarantee is immaterial to both:

(a) The firm or the individual making the loan or guarantee, as applicable; and

(b) The client.

Loans and Guarantees with an Assurance Client that is a Bank or Similar Institution

R911.5 A firm, an assurance team member, or any of that individual's immediate family shall not accept a loan, or a guarantee of a loan, from an assurance client that is a bank or a similar institution unless the loan or guarantee is made under normal lending procedures, terms and conditions.

911.5 A1 Examples of loans include mortgages, bank overdrafts, car loans and credit card balances.

911.5 A2 Even if a firm receives a loan from an assurance client that is a bank or similar institution under normal lending procedures, terms and conditions, the loan might create a self-interest threat if it is material to the assurance client or firm receiving the loan.

911.5 A3 An example of an action that might be a safeguard to address such a self-interest threat is having the work reviewed by an appropriate reviewer, who is not an assurance team member, from a network firm that is not a beneficiary of the loan.

Deposit or Brokerage Accounts

R911.6 A firm, an assurance team member, or any of that individual's immediate family shall not have deposits or a brokerage account with an assurance client that is a bank, broker, or similar institution, unless the deposit or account is held under normal commercial terms.

Loans and Guarantees with an Assurance Client that is not a Bank or Similar Institution

R911.7 A firm or an assurance team member, or any of that individual's immediate family, shall not accept a loan from, or have a borrowing guaranteed by, an assurance client that is not a bank or similar institution, unless the loan or guarantee is immaterial to both:

(a) The firm, or the individual receiving the loan or guarantee, as applicable; and

(b) The client.

SECTION 920

BUSINESS RELATIONSHIPS

Introduction

920.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

920.2 A close business relationship with an assurance client or its management might create a self-interest or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

920.3 A1 This section contains references to the "materiality" of a financial interest and the "significance" of a business relationship. In determining whether such a financial interest is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

920.3 A2 Examples of a close business relationship arising from a commercial relationship or common financial interest include:

- Having a financial interest in a joint venture with either the assurance client or a controlling owner, director or officer or other individual who performs senior managerial activities for that client.
- Arrangements to combine one or more services or products of the firm with one or more services or products of the client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm distributes or markets the client's products or services, or the client distributes or markets the firm's products or services.

Firm, Assurance Team Member or Immediate Family Business Relationships

R920.4 A firm or an assurance team member shall not have a close business relationship with an assurance client or its management unless any financial interest is immaterial and the business relationship is insignificant to the client or its management and the firm or the assurance team member, as applicable.

920.4 A1 A self-interest or intimidation threat might be created if there is a close business relationship between the assurance client or its management and the immediate family of an assurance team member.

Buying Goods or Services

920.5 A1 The purchase of goods and services from an assurance client by a firm, or an assurance team member, or any of that individual's immediate family does not usually create a threat to independence if the transaction is in the normal course of business and at arm's length. However, such transactions might be of such a nature and magnitude that they create a self-interest threat.

920.5 A2 Examples of actions that might eliminate such a self-interest threat include:

- Eliminating or reducing the magnitude of the transaction.
- Removing the individual from the assurance team.

SECTION 921

FAMILY AND PERSONAL RELATIONSHIPS

Introduction

921.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

921.2 Family or personal relationships with client personnel might create a self-interest, familiarity or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

921.3 A1 A self-interest, familiarity or intimidation threat might be created by family and personal relationships between an assurance team member and a director or officer or, depending on their role, certain employees of the assurance client.

921.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The individual's responsibilities on the assurance team.
- The role of the family member or other individual within the assurance client, and the closeness of the relationship.

Immediate Family of an Assurance Team Member

921.4 A1 A self-interest, familiarity or intimidation threat is created when an immediate family member of an assurance team member is an employee in a position to exert significant influence over the underlying subject matter of the assurance engagement.

921.4 A2 Factors that are relevant in evaluating the level of such threats include:

- The position held by the immediate family member.
- The role of the assurance team member.

921.4 A3 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the assurance team.

921.4 A4 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the assurance team so that the assurance team member does not deal with matters that are within the responsibility of the immediate family member.

R921.5 An individual shall not participate as an assurance team member when any of that individual's immediate family:

(a) Is a director or officer of the assurance client;

(b) Is an employee in a position to exert significant influence over the subject matter information of the assurance engagement; or

(c) Was in such a position during any period covered by the engagement or the subject matter information.

Close Family of an Assurance Team Member

921.6 A1 A self-interest, familiarity or intimidation threat is created when a close family member of an assurance team member is:

(a) A director or officer of the assurance client; or

(b) An employee in a position to exert significant influence over the underlying subject matter or, in an attestation engagement, an employee in a position to exert significant influence over the subject matter information of the assurance engagement.

921.6 A2 Factors that are relevant in evaluating the level of such threats include:

- The nature of the relationship between the assurance team member and the close family member.
- The position held by the close family member.
- The role of the assurance team member.

921.6 A3 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the assurance team.

921.6 A4 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the assurance team so that the assurance team member does not deal with matters that are within the responsibility of the close family member.

Other Close Relationships of an Assurance Team Member

R921.7 An assurance team member shall consult in accordance with firm policies and procedures if the assurance team member has a close relationship with an individual who is not an immediate or close family member, but who is:

(a) A director or officer of the assurance client; or

(b) An employee in a position to exert significant influence over the underlying subject matter or, in an attestation engagement, an employee in a position to exert significant influence over the subject matter information of the assurance engagement.

921.7 A1 Factors that are relevant in evaluating the level of a self-interest, familiarity or intimidation threat created by such relationships include:

- The nature of the relationship between the individual and the assurance team member.
- The position the individual holds with the client.
- The role of the assurance team member.

921.7 A2 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the assurance team.

921.7 A3 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the assurance team so that the assurance team member does not deal with matters that are within the responsibility of the individual with whom the assurance team member has a close relationship.

Relationships of Partners and Employees of the Firm

921.8 A1 A self-interest, familiarity or intimidation threat might be created by a personal or family relationship between:

(a) A partner or employee of the firm who is not an assurance team member; and

(b) Any of the following individuals at the assurance client:

i. A director or officer;

ii. An employee in a position to exert significant influence over the underlying subject matter or an employee in a position to exert significant influence over the subject matter information of the assurance engagement.

921.8 A2 Factors that are relevant in evaluating the level of such threats include:

- The nature of the relationship between the partner or employee of the firm and the director or officer or employee of the client.
- The degree of interaction of the partner or employee of the firm with the assurance team.
- The position of the partner or employee within the firm.
- The role of the individual within the client.

921.8 A3 Examples of actions that might be safeguards to address such self-interest, familiarity or intimidation threats include:

- Structuring the partner's or employee's responsibilities to reduce any potential influence over the assurance engagement.
- Having an appropriate reviewer review the relevant assurance work performed.

SECTION 922

RECENT SERVICE WITH AN ASSURANCE CLIENT

Introduction

922.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

922.2 If an assurance team member has recently served as a director or officer or employee of the assurance client, a self-interest, self-review or familiarity threat might be created. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Service During the Period Covered by the Assurance Report

R922.3 The assurance team shall not include an individual who, during the period covered by the assurance report:

(a) Had served as a director or officer of the assurance client; or

(b) Was an employee in a position to exert significant influence over underlying subject matter or, in an attestation engagement, employee in a position to exert significant influence over the subject matter information of the assurance engagement.

Service Prior to the Period Covered by the Assurance Report

922.4 A1 A self-interest, self-review or familiarity threat might be created if, before the period covered by the assurance report, an assurance team member:

(a) Had served as a director or officer of the assurance client; or

(b) Was an employee in a position to exert significant influence over underlying subject matter or, in an attestation engagement, employee in a position to exert significant influence over the subject matter information of the assurance engagement.

For example, a threat would be created if a decision made or work performed by the individual in the prior period, while employed by the client, is to be evaluated in the current period as part of the current assurance engagement.

922.4 A2 Factors that are relevant in evaluating the level of such threats include:

- The position the individual held with the client.
- The length of time since the individual left the client.
- The role of the assurance team member.

922.4 A3 An example of an action that might be a safeguard to address such a self-interest, self-review or familiarity threat is having an appropriate reviewer review the work performed by the assurance team member.

SECTION 923

SERVING AS A DIRECTOR OR OFFICER OF AN ASSURANCE CLIENT

Introduction

923.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

923.2 Serving as a director or officer of an assurance client creates self-review and self-interest threats. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Service as Director or Officer

R923.3 A partner or employee of the firm shall not serve as a director or officer of an assurance client of the firm.

Service as Company Secretary

R923.4 A partner or employee of the firm shall not serve as Company Secretary for an assurance client of the firm unless:

(a) This practice is specifically permitted under local law, professional rules or practice;

(b) Management makes all decisions; and

(c) The duties and activities performed are limited to those of a routine and administrative nature, such as preparing minutes and maintaining statutory returns.

923.4 A1 The position of Company Secretary has different implications in different jurisdictions. Duties might range from: administrative duties (such as personnel management and the maintenance of company records and registers) to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Usually this position is seen to imply a close association with the entity. Therefore, a threat is created if a partner or employee of the firm serves as Company Secretary for an assurance client. (More information on providing non-assurance services to an assurance client is set out in Section 950, *Provision of Non-assurance Services to an Assurance Client.)*

SECTION 924

EMPLOYMENT WITH AN ASSURANCE CLIENT

Introduction

924.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

924.2 Employment relationships with an assurance client might create a self-interest, familiarity or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

924.3 A1 A familiarity or intimidation threat might be created if any of the following individuals have been an assurance team member or partner of the firm:

- A director or officer of the assurance client.
- An employee in a position to exert significant influence over the underlying subject matter or, in an attestation engagement, an employee who is in a position to exert significant influence over the subject matter information of the assurance engagement.

Former Partner or Assurance Team Member Restrictions

R924.4 If a former partner has joined an assurance client of the firm or a former assurance team member has joined the assurance client as:

(a) A director or officer; or

(b) An employee in a position to exert significant influence over the underlying subject matter or, in an attestation engagement, an employee in a position to exert significant influence over the subject matter information of the assurance engagement, the individual shall not continue to participate in the firm's business or professional activities.

924.4 A1 Even if one of the individuals described in paragraph R924.4 has joined the assurance client in such a position and does not continue to participate in the firm's business or professional activities, a familiarity or intimidation threat might still be created.

924.4 A2 A familiarity or intimidation threat might also be created if a former partner of the firm has joined an entity in one of the positions described in paragraph 924.3 A1 and the entity subsequently becomes an assurance client of the firm.

924.4 A3 Factors that are relevant in evaluating the level of such threats include:

- The position the individual has taken at the client.

- Any involvement the individual will have with the assurance team.
- The length of time since the individual was an assurance team member or partner of the firm.
- The former position of the individual within the assurance team or firm. An example is whether the individual was responsible for maintaining regular contact with the client's management or those charged with governance.

924.4 A4 Examples of actions that might be safeguards to address such a familiarity or intimidation threat include:

- Making arrangements such that the individual is not entitled to any benefits or payments from the firm, unless made in accordance with fixed pre-determined arrangements.
- Making arrangements such that any amount owed to the individual is not material to the firm.
- Modifying the plan for the assurance engagement.
- Assigning to the assurance team individuals who have sufficient experience relative to the individual who has joined the client.
- Having an appropriate reviewer review the work of the former assurance team member.

Assurance Team Members Entering Employment Negotiations with a Client

R924.5 A firm shall have policies and procedures that require assurance team members to notify the firm when entering employment negotiations with an assurance client.

924.5 A1 A self-interest threat is created when an assurance team member participates in the assurance engagement while knowing that the assurance team member will, or might, join the client sometime in the future.

924.5 A2 An example of an action that might eliminate such a self-interest threat is removing the individual from the assurance engagement.

924.5 A3 An example of an action that might be a safeguard to address such a self-interest threat is having an appropriate reviewer review any significant judgements made by that assurance team member while on the team.

SECTION 940

LONG ASSOCIATION OF PERSONNEL WITH AN ASSURANCE CLIENT

Introduction

940.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

940.2 When an individual is involved in an assurance engagement of a recurring nature over a long period of time, familiarity and self-interest threats might be created. This section sets out requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

940.3 A1 A familiarity threat might be created as a result of an individual's long association with:

(a) The assurance client;

(b) The assurance client's senior management; or

(c) The underlying subject matter or, in an attestation engagement, subject matter information of the assurance engagement.

940.3 A2 A self-interest threat might be created as a result of an individual's concern about losing a longstanding assurance client or an interest in maintaining a close personal relationship with a member of senior management or those charged with governance. Such a threat might influence the individual's judgement inappropriately.

940.3 A3 Factors that are relevant to evaluating the level of such familiarity or self-interest threats include:

- The nature of the assurance engagement.
- How long the individual has been an assurance team member, the individual's seniority on the team, and the nature of the roles performed, including if such a relationship existed while the individual was at a prior firm.
- The extent to which the work of the individual is directed, reviewed and supervised by more senior personnel.
- The extent to which the individual, due to the individual's seniority, has the ability to influence the outcome of the assurance engagement, for example, by making key decisions or directing the work of other engagement team members.
- The closeness of the individual's personal relationship with the assurance client or, if relevant, senior management.
- The nature, frequency and extent of interaction between the individual and the assurance client.
- Whether the nature or complexity of the underlying subject matter or subject matter information has changed.

- Whether there have been any recent changes in the individual or individuals at the assurance client who are responsible for the underlying subject matter or, in an attestation engagement, the subject matter information or, if relevant, senior management.

940.3 A4 The combination of two or more factors might increase or reduce the level of the threats. For example, familiarity threats created over time by the increasingly close relationship between an assurance team member and an individual at the assurance client who is in a position to exert significant influence over the underlying subject matter or, in an attestation engagement, the subject matter information, would be reduced by the departure of that individual from the client.

940.3 A5 An example of an action that might eliminate the familiarity and self-interest threats in relation to a specific engagement would be rotating the individual off the assurance team.

940.3 A6 Examples of actions that might be safeguards to address such familiarity or self-interest threats include:

- Changing the role of the individual on the assurance team or the nature and extent of the tasks the individual performs.
- Having an appropriate reviewer who was not an assurance team member review the work of the individual.
- Performing regular independent internal or external quality reviews of the engagement.

R940.4 If a firm decides that the level of the threats created can only be addressed by rotating the individual off the assurance team, the firm shall determine an appropriate period during which the individual shall not:

(a) Be a member of the engagement team for the assurance engagement;

(b) Provide quality control for the assurance engagement; or

(c) Exert direct influence on the outcome of the assurance engagement.

The period shall be of sufficient duration to allow the familiarity and self-interest threats to be addressed.

SECTION 950

PROVISION OF NON-ASSURANCE SERVICES TO ASSURANCE CLIENTS

Introduction

950.1 Firms are required to comply with the fundamental principles, be independent, and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

950.2 Firms might provide a range of non-assurance services to their assurance clients, consistent with their skills and expertise. Providing certain non-assurance services to assurance clients might create threats to compliance with the fundamental principles and threats to independence. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

R950.3 Before a firm accepts an engagement to provide a non-assurance service to an assurance client, the firm shall determine whether providing such a service might create a threat to independence.

950.3 A1 The requirements and application material in this section assist firms in analysing certain types of non-assurance services and the related threats that might be created when a firm accepts or provides non-assurance services to an assurance client.

950.3 A2 New business practices, the evolution of financial markets and changes in information technology are among the developments that make it impossible to draw up an all-inclusive list of non-assurance services that might be provided to an assurance client. As a result, the Code does not include an exhaustive listing of all non-assurance services that might be provided to an assurance client.

Evaluating Threats

950.4 A1 Factors that are relevant in evaluating the level of threats created by providing a non-assurance service to an assurance client include:

- The nature, scope and purpose of the service.
- The degree of reliance that will be placed on the outcome of the service as part of the assurance engagement.
- The legal and regulatory environment in which the service is provided.
- Whether the outcome of the service will affect the underlying subject matter and, in an attestation engagement, matters reflected in the subject matter information of the assurance engagement, and, if so:
    - o The extent to which the outcome of the service will have a material or significant effect on the underlying subject matter and, in an attestation engagement, the subject matter information of the assurance engagement.
    - o The extent of the assurance client's involvement in determining significant matters of judgement.

- The level of expertise of the client's management and employees with respect to the type of service provided.

Materiality in Relation to an Assurance Client's Information

950.4 A2 The concept of materiality in relation to an assurance client's subject matter information is addressed in *International Standard on Assurance Engagements (New Zealand) (ISAE (NZ)) 3000 (Revised), Assurance Engagements other than Audits or Reviews of Historical Financial Information*. The determination of materiality involves the exercise of professional judgement and is impacted by both quantitative and qualitative factors. It is also affected by perceptions of the financial or other information needs of users.

Multiple Non-assurance Services Provided to the Same Assurance Client

950.4 A3 A firm might provide multiple non-assurance services to an assurance client. In these circumstances the combined effect of threats created by providing those services is relevant to the firm's evaluation of threats.

Addressing Threats

950.5 A1 Paragraph 120.10 A2 includes a description of safeguards. In relation to providing non-assurance services to assurance clients, safeguards are actions, individually or in combination, that the firm takes that effectively reduce threats to independence to an acceptable level. In some situations, when a threat is created by providing a service to an assurance client, safeguards might not be available. In such situations, the application of the conceptual framework set out in Section 120 requires the firm to decline or end the non-assurance service or the assurance engagement.

Prohibition on Assuming Management Responsibilities

R950.6 A firm shall not assume a management responsibility related to the underlying subject matter and, in an attestation engagement, the subject matter information of an assurance engagement provided by the firm. If the firm assumes a management responsibility as part of any other service provided to the assurance client, the firm shall ensure that the responsibility is not related to the underlying subject matter and, in an attestation engagement, the subject matter information of the assurance engagement provided by the firm.

950.6 A1 Management responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources.

950.6 A2 Providing a non-assurance service to an assurance client creates self-review and self-interest threats if the firm assumes a management responsibility when performing the service. In relation to providing a service related to the underlying subject matter and, in an attestation engagement, the subject matter information of an assurance engagement provided by the firm, assuming a management responsibility also creates a familiarity threat and might create an advocacy threat because the firm becomes too closely aligned with the views and interests of management.

950.6 A3 Determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of professional judgement. Examples of activities that would be considered a management responsibility include:

- Setting policies and strategic direction.
- Hiring or dismissing employees.
- Directing and taking responsibility for the actions of employees in relation to the employees' work for the entity.
- Authorising transactions.
- Controlling or managing bank accounts or investments.
- Deciding which recommendations of the firm or other third parties to implement.
- Reporting to those charged with governance on behalf of management.
- Taking responsibility for designing, implementing, monitoring and maintaining internal control.

950.6 A4 Providing advice and recommendations to assist the management of an assurance client in discharging its responsibilities is not assuming a management responsibility. (Ref: Paras. R950.6 to 950.6 A3).

R950.7 To avoid assuming a management responsibility when providing non-assurance services to an assurance client that are related to the underlying subject matter and, in an attestation engagement, the subject matter information of the assurance engagement, the firm shall be satisfied that client management makes all related judgements and decisions that are the proper responsibility of management. This includes ensuring that the client's management:

(a) Designates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client's decisions and to oversee the services. Such an individual, preferably within senior management, would understand:

(i) The objectives, nature and results of the services; and

(ii) The respective client and firm responsibilities.

However, the individual is not required to possess the expertise to perform or re-perform the services.

(b) Provides oversight of the services and evaluates the adequacy of the results of the service performed for the client's purpose; and

(c) Accepts responsibility for the actions, if any, to be taken arising from the results of the services.

Other Considerations Related to Providing Specific Non-Assurance Services

950.8 A1 A self-review threat might be created if, in an attestation engagement, the firm is involved in the preparation of subject matter information which subsequently becomes the subject matter information of an assurance engagement. Examples of non-assurance services that might create such self-review threats when providing services related to the subject matter information of an assurance engagement include:

(a) Developing and preparing prospective information and subsequently issuing an assurance report on this information.

(b) Performing a valuation that is related to or forms part of the subject matter information of an assurance engagement.

SECTION 990

REPORTS THAT INCLUDE A RESTRICTION ON USE AND DISTRIBUTION (ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS)

Introduction

990.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

990.2 This section sets out certain modifications to Part 4B which are permitted in certain circumstances involving assurance engagements where the report includes a restriction on use and distribution. In this section, an engagement to issue a restricted use and distribution assurance report in the circumstances set out in paragraph R990.3 is referred to as an "eligible assurance engagement."

Requirements and Application Material

General

R990.3 When a firm intends to issue a report on an assurance engagement which includes a restriction on use and distribution, the independence requirements set out in Part 4B shall be eligible for the modifications that are permitted by this section, but only if:

- **(a)** The firm communicates with the intended users of the report regarding the modified independence requirements that are to be applied in providing the service; and
- **(b)** The intended users of the report understand the purpose, subject matter information and limitations of the report and explicitly agree to the application of the modifications.

990.3 A1 The intended users of the report might obtain an understanding of the purpose, subject matter information, and limitations of the report by participating, either directly, or indirectly through a representative who has authority to act for the intended users, in establishing the nature and scope of the engagement. In either case, this participation helps the firm to communicate with intended users about independence matters, including the circumstances that are relevant to applying the conceptual framework. It also allows the firm to obtain the agreement of the intended users to the modified independence requirements.

R990.4 Where the intended users are a class of users who are not specifically identifiable by name at the time the engagement terms are established, the firm shall subsequently make such users aware of the modified independence requirements agreed to by their representative.

990.4 A1 For example, where the intended users are a class of users such as lenders in a syndicated loan arrangement, the firm might describe the modified independence requirements in an engagement letter to the representative of the lenders. The representative might then make the firm's engagement letter available to the members of the group of lenders to meet the requirement for the firm to make such users aware of the modified independence requirements agreed to by the representative.

R990.5 When the firm performs an eligible assurance engagement, any modifications to Part 4B shall be limited to those modifications set out in paragraphs R990.7 and R990.8.

R990.6 If the firm also issues an assurance report that does not include a restriction on use and distribution for the same client, the firm shall apply Part 4B to that assurance engagement.

Financial Interests, Loans and Guarantees, Close Business, Family and Personal Relationships

R990.7 When the firm performs an eligible assurance engagement:

- **(a)** The relevant provisions set out in Sections 910, 911, 920, 921, 922 and 924 need apply only to the members of the engagement team, and their immediate and close family members;
- **(b)** The firm shall identify, evaluate and address any threats to independence created by interests and relationships, as set out in Sections 910, 911, 920, 921, 922 and 924, between the assurance client and the following assurance team members;
  - **(i)** Those who provide consultation regarding technical or industry specific issues, transactions or events; and
  - **(ii)** Those who provide quality control for the engagement, including those who perform the engagement quality control review; and
- **(c)** The firm shall evaluate and address any threats that the engagement team has reason to believe are created by interests and relationships between the assurance client and others within the firm who can directly influence the outcome of the assurance engagement, as set out in Sections 910, 911, 920, 921, 922 and 924.

990.7 A1 Others within the firm who can directly influence the outcome of the assurance engagement include those who recommend the compensation, or who provide direct supervisory, management or other oversight, of the assurance engagement partner in connection with the performance of the assurance engagement.

R990.8 When the firm performs an eligible assurance engagement, the firm shall not hold a material direct or a material indirect financial interest in the assurance client.

GLOSSARY

In the *International Code of Ethics for Professional Accountants (including International Independence Standards)*, the singular shall be construed as including the plural as well as the reverse, and the terms below have the following meanings assigned to them.

In this Glossary, explanations of defined terms are shown in regular font; italics are used for explanations of described terms which have a specific meaning in certain parts of the Code or for additional explanations of defined terms. References are also provided to terms described in the Code.

Acceptable level	A level at which an assurance practitioner using the reasonable and informed third party test would likely conclude that the assurance practitioner complies with the fundamental principles.
Advertising	The communication to the public of information as to the services or skills provided by assurance practitioners with a view to procuring assurance business.
Appropriate reviewer	*An appropriate reviewer is a professional with the necessary knowledge, skills, experience and authority to review, in an objective manner, the relevant work performed or service provided. Such an individual might be an assurance practitioner.* *This term is described in paragraph 300.8 A4.*
Assurance client	The responsible party and also, in an attestation engagement, the party taking responsibility for the subject matter information (who might be the same as the responsible party).
Assurance engagement	An engagement in which an assurance practitioner aims to obtain sufficient appropriate evidence in or to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the subject matter information (that is, the outcome of the measurement or evaluation of an underlying subject matter against criteria). (ISAE (NZ) 3000 (Revised) describes the elements and objectives of an assurance engagement conducted under that Standard and Explanatory Guide (EG) Au1 *Overview of Auditing and Assurance Standards* provides a general description of assurance engagements to which *International Standards on Auditing (New Zealand)* (ISAs (NZ)), *International Standards on Review Engagements (New Zealand)* (ISREs (NZ)), New Zealand Standard on Review Engagements (NZ SRE), *International Standards on Assurance Engagements (New Zealand)* (ISAEs (NZ)), and Standards on Assurance Engagements (SAEs) apply.) *In Part 4B, the term 'assurance engagement' refers to assurance engagements that are not audit or review engagements.*

[NZ] Assurance practitioner

A person or organisation, whether in public practice, industry, commerce or the public sector, appointed or engaged to undertake assurance engagements.

[NZ] Assurance services

Comprise of any assurance engagements performed by an assurance practitioner.

Assurance team

(a) All members of the engagement team for the assurance engagement;

(b) All others within a firm who can directly influence the outcome of the assurance engagement, including:

  (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement partner in connection with the performance of the assurance engagement;

  (ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement; and

  (iii) Those who provide quality control for the assurance engagement, including those who perform the engagement quality control review for the assurance engagement.

Attestation engagement

An assurance engagement in which a party other than the assurance practitioner measures or evaluates the underlying subject matter against the criteria. A party other than the assurance practitioner also often presents the resulting subject matter in formation in a report or statement. In some cases, however, the subject matter information may be presented by the assurance practitioner in the assurance report. In an attestation engagement, the assurance practitioner's conclusion addresses whether the subject matter information is free from material misstatement. The assurance practitioner's conclusion may be phrased in terms of:

(a) The underlying subject matter and the applicable criteria;

(b) The subject matter information and the applicable criteria; or

(c) A statement made by the appropriate party(ies).

[NZ] Audit client

An entity in respect of which a firm conducts an audit engagement. When the client is a FMC reporting entity considered to have a higher level of public accountability, audit client will always include its related entities. When the audit client is not a FMC reporting entity considered to have a higher level of public accountability, audit client includes those related entities over which the client has direct or indirect control. *(See also paragraph R400.20.)*

Audit engagement

A reasonable assurance engagement in which an assurance practitioner expresses an opinion whether financial statements are prepared, in all material respects (or give a true and fair view or are presented fairly, in all material respects), in accordance with an applicable financial reporting framework, such as an engagement conducted in accordance with *International Standards on Auditing (New Zealand)*. This includes a Statutory Audit, which is an audit required by legislation or other regulation.

Audit team

(a) All members of the engagement team for the audit engagement;

(b) All others within a firm who can directly influence the outcome of the audit engagement, including:

  (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the audit engagement, including those at all successively senior levels above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent);

  (ii) Those who provide consultation regarding technical or industry-specific issues, transactions or events for the engagement; and

  (iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and

(c) All those within a network firm who can directly influence the outcome of the audit engagement.

Close family

A parent, child or sibling who is not an immediate family member.

Conceptual framework

This term is described in Section 120.

Contingent fee

A fee calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm. A fee that is established by a court or other public authority is not a contingent fee.

Cooling-off period

This term is described in paragraph R540.5 for the purposes of paragraphs R540.11 to R540.19.

Criteria

In an assurance engagement, the benchmarks used to measure or evaluate the underlying subject matter. The "applicable criteria" are the criteria used for the particular engagement.

Direct engagement	An assurance engagement in which the assurance practitioner measures or evaluates the underlying subject matter against the applicable criteria and the assurance practitioner presents the resulting subject matter information as part of, or accompanying, the assurance report. In a direct engagement, the assurance practitioner's conclusion addresses the reported outcome of the measurement or evaluation of the underlying subject matter against the criteria.
Direct financial interest	A financial interest: (a) Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or (b) Beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control, or the ability to influence investment decisions.
Director or officer	Those charged with the governance of an entity, or acting in an equivalent capacity, regardless of their title, which might vary from jurisdiction to jurisdiction.
Eligible audit engagement	*This term is described in paragraph 800.2 for the purposes of Section 800.*
Eligible assurance engagement	*This term is described in paragraph 990.2 for the purposes of Section 990.*
Engagement partner[1]	The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
Engagement period (Audit and Review Engagements)	The engagement period starts when the audit or review team begins to perform the audit or review. The engagement period ends when the audit or review report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final audit or review report.
Engagement period (Assurance Engagements Other than Audit and Review Engagements)	The engagement period starts when the assurance team begins to perform assurance services with respect to the particular engagement. The engagement period ends when the assurance report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final assurance report.

[1] Engagement partner: should be read as referring to their public sector equivalents where relevant.

Engagement quality control review
A process designed to provide an objective evaluation, on or before the report is issued, of the significant judgements the engagement team made and the conclusions it reached in formulating the report.

Engagement team
All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or by a network firm.

The term "engagement team" also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013), *Using the Work of Internal Auditors.*

Existing accountant
An accountant currently holding an audit appointment or carrying out accounting, tax, consulting or similar non-assurance services for a client.

External expert
An individual (who is not a partner or a member of the professional staff, including temporary staff, of the firm or a network firm) or organisation possessing skills, knowledge and experience in a field other than accounting or auditing, whose work in that field is used to assist the assurance practitioner in obtaining sufficient appropriate evidence.

Financial interest
An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.

Financial statements
A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term can relate to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.

The term does not refer to specific elements, accounts or items of a financial statement.

Financial statements on which the firm will express an opinion
In the case of a single entity, the financial statements of that entity. In the case of consolidated financial statements, also referred to as group financial statements, the consolidated financial statements.

Firm
(a) A sole practitioner, partnership or corporation undertaking assurance engagements;

(b) An entity that controls such parties, through ownership, management or other means; and

	(c) An entity controlled by such parties, through ownership, management or other means. *Paragraphs 400.4 and 900.3 explain how the word "firm" is used to address the responsibility of professional accountants and firms for compliance with Parts 4A and 4B, respectively.*
[NZ] FMC reporting entity considered to have a higher level of public accountability	A FMC reporting entity of a class of FMC reporting entity that is considered to have a higher level of public accountability than other FMC reporting entities: • Under section 461K of the Financial Markets Conduct Act 2013; or • By notice issued by the Financial Markets Authority under section 461L(1)(1) of the Financial Markets Conduct Act 2013.
Fundamental principles	*This term is described in paragraph 110.1 A1. Each of the fundamental principles is, in turn, described in the following paragraphs:* *Integrity* — *R111.1* *Objectivity* — *R112.1* *Professional competence and due care* — *R113.1* *Confidentiality* — *R114.1* *Professional behaviour* — *R115.1*
Historical financial information	Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.
Immediate family	A spouse (or equivalent) or dependent.
Independence	Independence comprises: (a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, thereby allowing an individual to act with integrity, and exercise objectivity and professional scepticism. (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's, or an audit or assurance team member's, integrity, objectivity or professional scepticism has been compromised.

As set out in paragraphs 400.5 and 900.4, references to an individual or firm being "independent" mean that the individual or firm has complied with Parts 4A and 4B, as applicable.

Indirect financial interest — A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control or ability to influence investment decisions.

Inducement — An object, situation, or action that is used as a means to influence another individual's behaviour, but not necessarily with the intent to improperly influence that individual's behaviour.

Inducements can range from minor acts of hospitality between assurance practitioners and existing or prospective clients to acts that result in non-compliance with laws and regulations. An inducement can take many different forms, for example:

- *Gifts.*
- *Hospitality.*
- *Entertainment.*
- *Political or charitable donations.*
- *Appeals to friendship and loyalty.*
- *Employment or other commercial opportunities.*
- *Preferential treatment, rights or privileges.*

Key audit partner — The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgements on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, "other audit partners" might include, for example, audit partners responsible for significant subsidiaries or divisions.

[NZ] Key assurance partner — The engagement partner, the individual responsible for the engagement quality control review, and other assurance partners, if any, on the engagement team who make key decisions or judgements on significant matters with respect to the assurance engagement.

Listed entity — [*Deleted by the NZAuASB]*

May — *This term is used in the Code to denote permission to take a particular action in certain circumstances, including as an exception to a requirement. It is not used to denote possibility.*

Might — *This term is used in the Code to denote the possibility of a matter arising, an event occurring or a course of action being taken. The term does not*

	ascribe any particular level of possibility or likelihood when used in conjunction with a threat, as the evaluation of the level of a threat depends on the facts and circumstances of any particular matter, event or course of action.
Network	A larger structure: (a) That is aimed at co-operation; and (b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.
Network firm	A firm or entity that belongs to a network. *For further information, see paragraphs 400.50 A1 to 400.54 A1.*
Non-compliance with laws and regulations	*Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:* *(a) A client;* *(b) Those charged with governance of a client;* *(c) Management of a client; or* *(d) Other individuals working for or under the direction of a client.* *This term is described in paragraph 360.5 A1.*
[NZ] Offer document	A document, such as a product disclosure statement or a disclosure document, required by legislation to be prepared by an entity when financial products are offered to the public.
Office	A distinct sub-group, whether organised on geographical or practice lines.
Predecessor accountant	A professional accountant in public practice who most recently held an audit appointment or carried out accounting, tax, consulting or similar professional services for a client, where there is no existing accountant.
Professional accountant	*[Deleted by the NZAuASB]*
Professional accountant in business	*[Deleted by the NZAuASB]*

Professional accountant in public practice

[Deleted by the NZAuASB]

Professional activity

An activity requiring accountancy or related skills undertaken by an assurance practitioner, including accounting, auditing, tax, management consulting, and financial management.

Professional services

Professional activities performed for clients.

[NZ] Proposed assurance practitioner

An assurance practitioner who is considering accepting an audit, review or assurance appointment for a prospective client (or in some cases, an existing client).

[NZ] Public interest entity

Any entity that meets the Tier 1 criteria in accordance with XRB A1[2] and is not eligible to report in accordance with the accounting requirements of another tier.

Reasonable and informed third party

Reasonable and informed third party test

The reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the conclusions are made. The reasonable and informed third party does not need to be an accountant, but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant's conclusions in an impartial manner.

These terms are described in paragraph R120.5 A4.

Related entity

An entity that has any of the following relationships with the client:

(a) An entity that has direct or indirect control over the client if the client is material to such entity;

(b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity;

(c) An entity over which the client has direct or indirect control;

(d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and

[2] XRB A1 *Application of the Accounting Standards Framework*

(e) An entity which is under common control with the client (a "sister entity") if the sister entity and the client are both material to the entity that controls both the client and sister entity.

Responsible party	In an assurance engagement, the party responsible for the underlying subject matter.
Review client	An entity in respect of which a firm conducts a review engagement.
Review engagement	An assurance engagement, conducted in accordance with *International Standards on Review Engagements (New Zealand) 2400* or New Zealand Standard on Review Engagements 2410, in which an assurance practitioner expresses a conclusion on whether, on the basis of the procedures which do not provide all the evidence that would be required in an audit, anything has come to the assurance practitioner's attention that causes the assurance practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.
Review team	(a) All members of the engagement team for the review engagement; and (b) All others within a firm who can directly influence the outcome of the review engagement, including: (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the review engagement, including those at all successively senior levels above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent); (ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the engagement; and (iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and (c) All those within a network firm who can directly influence the outcome of the review engagement.
Safeguards	*Safeguards are actions, individually or in combination, that the professional accountant takes that effectively reduce threats to compliance with the fundamental principles to an acceptable level.* *This term is described in paragraph 120.10 A2.*
Substantial harm	*This term is described in paragraph 360.5 A3.*

Special purpose financial statements	Financial statements prepared in accordance with a financial reporting framework designed to meet the financial information needs of specified users.
Subject matter information	The outcome of the measurement or evaluation of the underlying subject matter against the criteria, i.e., the information that results from applying the criteria to the underlying subject matter.
Those charged with governance	The person(s) or organisation(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance might include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.
Threats	*This term is described in paragraph 120.6 A3 and includes the following categories:* *Self interest* — *120.6 A3(a)* *Self-review* — *120.6 A3(b)* *Advocacy* — *120.6 A3(c)* *Familiarity* — *120.6 A3(d)* *Intimidation* — *120.6 A3(e)*
Time-on period	*This term is described in paragraph R540.5.*
Underlying subject matter	The phenomenon that is measured or evaluated by applying criteria.

C: EFFECTIVE DATE

Part 4B relating to independence for assurance engagements with respect to underlying subject matter covering periods will be effective for periods beginning on or after 15 June 2021; otherwise, it will be effective on 15 June 2021. Early adoption will be permitted.

NZ AUDITING AND ASSURANCE STANDARDS BOARD

AMENDMENTS TO PROFESSIONAL AND ETHICAL STANDARD 1: PART 4B -- INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

This Standard was issued on 1 March 2020 by the New Zealand Auditing and Assurance Standards Board of the External Reporting Board pursuant to section 12(b) of the Financial Reporting Act 2013.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012, and pursuant to section 27(1) of the Financial Reporting Act 2013 takes effect on 28 March 2020.

An assurance practitioner that is required to apply this Standard is required to apply it to underlying subject matter covering periods for periods beginning on or after 15 June 2021; otherwise, it will be effective on 15 June 2021. Early adoption will be permitted.

In finalising this Standard, the New Zealand Auditing and Assurance Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

This Standard has been issued as a result of revision of Part 4B of the International Code of Ethics for Professional Accountants, including International Independence Standards by the International Ethics Standards Board for Accountants.

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AMENDMENTS TO PROFESSIONAL AND ETHICAL STANDARD 1: PART 4B, INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

CONTENTS

A: INTRODUCTION

This document sets out amendments to Professional and Ethical Standard (PES) *1 International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*. These amendments have been issued as a result of changes made to the International Code of Ethics for Professional Accountants issued by IESBA.

Section B of this document sets out amendments to Part 4B, *Independence for Assurance Engagements Other Than Audit and Review Engagements,* of PES 1. New text is underlined and deleted text is struck through.

B: AMENDMENTS TO PART 4B – INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

PART 4B – INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

SECTION 900

APPLYING THE CONCEPTUAL FRAMEWORK TO INDEPENDENCE FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS

Introduction

General

900.1 This Part applies to assurance engagements other than audit engagements and review engagements ~~(referred to as "assurance engagements" in this Part)~~. Examples of such engagements include:

- ~~An audit of specific elements, accounts or items of a financial statement.~~
- ~~Performance a~~Assurance on an entity's ~~company's~~ key performance indicators.
- Assurance on an entity's compliance with law or regulation.
- Assurance on performance criteria, such as value for money, achieved by a public sector body.
- Assurance on the effectiveness of an entity's system of internal control.
- Assurance on an entity's greenhouse gas statement.
- An audit of specific elements, accounts or items of a financial statement.

900.2 In this Part, the term "assurance practitioner" refers to individual assurance practitioners and their firms.

900.3 Professional and Ethical Standard 3 (Amended), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements,* ~~-~~ requires a firm to establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements maintain independence where required by relevant ethics standards. In addition, International Standards on Assurance Engagements (New Zealand), ~~and~~ Standards on Assurance Engagements and International Standards on Auditing (New Zealand) establish responsibilities for engagement partners and engagement teams at the level of the engagement. The allocation of responsibilities within a firm will depend on its size, structure and organisation. Many of the provisions of Part 4B do not prescribe the specific responsibility of individuals within the firm for actions related to independence, instead referring to "firm" for ease of reference. Firms assign responsibility for a particular action to an individual or a group of individuals (such as an assurance team) in accordance with Professional and Ethical Standard 3 (Amended). ~~In addition~~Additionally, an individual assurance practitioner remains responsible for compliance with any provisions that apply to that assurance practitioner's activities, interests or relationships.

900.4 Independence is linked to the principles of objectivity and integrity. It comprises:

(a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, thereby allowing an individual to act with integrity, and exercise objectivity and professional scepticism.

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's or an assurance team member's integrity, objectivity or professional scepticism has been compromised.

In this Part, references to an individual or firm being "independent" mean that the individual or firm has complied with the provisions of this Part.

900.5 When performing assurance engagements, the Code requires firms to comply with the fundamental principles and be independent. This Part sets out specific requirements and application material on how to apply the conceptual framework to maintain independence when performing ~~such~~ assurance engagements other than audit or review engagements. The conceptual framework set out in Section 120 applies to independence as it does to the fundamental principles set out in Section 110.

900.6 This Part describes:

(a) Facts and circumstances, including professional activities, interests and relationships, that create or might create threats to independence;

(b) Potential actions, including safeguards, that might be appropriate to address any such threats; and

(c) Some situations where the threats cannot be eliminated or there can be no safeguards to reduce the threats to an acceptable level.

Description of ~~Other~~ Assurance Engagements

900.7 ~~Assurance engagements are designed to enhance intended users' degree of confidence about the outcome of the evaluation or measurement of a subject matter against criteria.~~ In an assurance engagement, the firm aims to obtain sufficient appropriate evidence in order to express~~es~~ a conclusion designed to enhance the degree of confidence of the intended users (other than the responsible party) about the ~~outcome~~ subject matter information. ISAE (NZ) 3000 (Revised) describes the elements and objectives of an assurance engagement conducted under that Standard, and Explanatory Guide (EG) Au1A, *Framework for Assurance Engagements*, provides a general description of assurance engagements. An assurance engagement might either be an attestation engagement or a direct engagement. ~~of the evaluation or measurement of a subject matter against criteria. Explanatory Guide (EG) Au1A, *Framework for Assurance Engagements*, describes the elements and objectives of an assurance engagement and identifies engagements to which the other assurance engagement standards apply. For a description of the elements and objectives of an assurance engagement, refer to the EG Au1A.~~

900.8 In this Part, the term 'assurance engagement' refers to assurance engagements other than audit engagements or review engagements. ~~The outcome of the evaluation or~~

~~measurement of a subject matter is the information that results from applying the criteria to the subject matter. The term "subject matter information" is used to mean the outcome of the evaluation or measurement of a subject matter. For example, the EG Au1A states that an assertion about the effectiveness of internal control (subject matter information) results from applying a framework for evaluating the effectiveness of internal control, such as COSO[1] or CoCo[2] (criteria), to internal control, a process (subject matter).~~

~~900.9 Assurance engagements might be assertion-based or direct reporting. In either case, they involve three separate parties: a firm, a responsible party and intended users.~~

~~900.10 In an assertion-based assurance engagement, the evaluation or measurement of the subject matter is performed by the responsible party. The subject matter information is in the form of an assertion by the responsible party that is made available to the intended users.~~

~~900.11 In a direct reporting assurance engagement, the firm:~~

~~(a) Directly performs the evaluation or measurement of the subject matter; or~~

~~(b) Obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report.~~

Reports that Include a Restriction on Use and Distribution

900.9~~12~~ An assurance report might include a restriction on use and distribution. If it does and the conditions set out in Section 990 are met, then the independence requirements in this Part may be modified as provided in Section 990.

Audit and Review Engagements

900.10~~3~~ Independence standards for audit and review engagements are set out in Part 4A – *Independence for Audit and Review Engagements*. If a firm performs both an assurance engagement and an audit or review engagement for the same client, the requirements in Part 4A continue to apply to the firm, a network firm and the audit or review team members.

NZ 900.10~~3~~.1 Part 4A also addresses the independence requirements for assurance engagements where assurance is provided in relation to an offer document of a FMC reporting entity considered to have a higher level of public accountability in respect of historical financial information, prospective or pro-forma financial information, or a combination of these.

Requirements and Application Material

General

R900.11~~4~~ A firm performing an assurance engagement shall be independent of the assurance client.

~~[1] Committee of Sponsoring Organisations of the Treadway Commission~~

~~[2] Chartered Professional Accountants of Canada Criteria of Control~~

900.11 A1 For the purposes of this Part, the assurance client in an assurance engagement is the responsible party and also, in an attestation engagement, the party taking responsibility for the subject matter information (who might be the same as the responsible party).

900.11 A2 The roles of the parties involved in an assurance engagement might differ and affect the application of the independence provisions in this Part. In the majority of attestation engagements, the responsible party and the party taking responsibility for the subject matter information are the same. This includes those circumstances where the responsible party involves another party to measure or evaluate the underlying subject matter against the criteria (the measurer or evaluator) where the responsible party takes responsibility for the subject matter information as well as the underlying subject matter. However, the responsible party or the engaging party might appoint another party to prepare the subject matter information. In this circumstance, the responsible party and that party responsible for the subject matter information are both assurance clients for the purposes of this Part.

900.11 A3 In addition to the responsible party and, in an attestation engagement, the party taking responsibility for the subject matter information, there might be other parties in relation to the engagement. For example, there might be a separate engaging party or a party who is a measurer or evaluator other than the party taking responsibility for the subject matter information. In these circumstances, applying the conceptual framework requires the professional accountant to identify and evaluate threats to the fundamental principles created by any interests or relationships with such parties, including whether any conflicts of interest might exist as described in Section 310.

R900.12~~5~~ A firm shall apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence in relation to an assurance engagement.

NZ R900.1~~5~~2.1 Where an assurance practitioner identifies multiple threats to independence, which individually may not be significant, the assurance practitioner shall evaluate the significance of those threats in aggregate and apply safeguards to eliminate or reduce them to an acceptable level in aggregate.

Multiple Responsible Parties and Parties Taking Responsibility for the Subject Matter Information

900.13 A1 In some assurance engagements, whether an attestation engagement or direct engagement, there might be several responsible parties or, in an attestation engagement, several parties taking responsibility for the subject matter information. In determining whether it is necessary to apply the provisions in this Part to each individual responsible party or each individual party taking responsibility for the subject matter information in such engagements, the firm may take into account certain matters. These matters include whether an interest or relationship between the firm, or an assurance team member, and a particular responsible party or party taking responsibility for the subject matter information would create a threat to independence that is not trivial and inconsequential in the context of the subject matter information. This determination will take into account factors such as:

(a) The materiality of the underlying subject matter or subject matter information for which the particular party is responsible in the context of the overall assurance engagement.
(b) The degree of public interest associated with the assurance engagement.

If the firm determines that the threat created by any such interest or relationship with a particular party would be trivial and inconsequential, it might not be necessary to apply all of the provisions of that section to that party.

Network F~~f~~irms

R900.14~~6~~ When a firm knows or has reason to believe that interests and relationships of a network firm create a threat to the firm's independence, the firm shall evaluate and address any such threat.

900.14~~6~~ A1 Network firms are discussed in paragraphs 400.50 A1 to 400.54 A1.

Related Entities

R900.15~~7~~ When the assurance team knows or has reason to believe that a relationship or circumstance involving a related entity of the assurance client is relevant to the evaluation of the firm's independence from the client, the assurance team shall include that related entity when identifying, evaluating and addressing threats to independence.

~~**Types of Assurance Engagements**~~

~~*Assertion-based Assurance Engagements*~~

~~**R900.18** When performing an assertion-based assurance engagement:~~

~~**(a)** The assurance team members and the firm shall be independent of the assurance client (the party responsible for the subject matter information, and which might be responsible for the subject matter) as set out in this Part. The independence requirements set out in this Part prohibit certain relationships between assurance team members and (i) directors or officers, and (ii) individuals at the client in a position to exert significant influence over the subject matter information;~~

~~**(b)** The firm shall apply the conceptual framework set out in Section 120 to relationships with individuals at the client in a position to exert significant influence over the subject matter of the engagement; and~~

~~**(c)** The firm shall evaluate and address any threats that the firm has reason to believe are created by network firm interests and relationships.~~

~~**R900.19** When performing an assertion-based assurance engagement where the responsible party is responsible for the subject matter information but not the subject matter:~~

~~**(a)** The assurance team members and the firm shall be independent of the party responsible for the subject matter information (the assurance client); and~~

~~**(b)** The firm shall evaluate and address any threats the firm has reason to believe are created by interests and relationships between an assurance team member, the firm, a network firm and the party responsible for the subject matter.~~

~~900.19 A1 In the majority of assertion-based assurance engagements, the responsible party is responsible for both the subject matter information and the subject matter. However, in some engagements, the responsible party might not be responsible for the subject matter. An example might be when a firm is engaged to perform an assurance engagement regarding a report that an environmental consultant has prepared about a~~

~~company's sustainability practices for distribution to intended users. In this case, the environmental consultant is the responsible party for the subject matter information but the company is responsible for the subject matter (the sustainability practices).~~

~~*Direct Reporting Assurance Engagements*~~

~~**R900.20** When performing a direct reporting assurance engagement:~~

~~**(a)** The assurance team members and the firm shall be independent of the assurance client (the party responsible for the subject matter); and~~

~~**(b)** The firm shall evaluate and address any threats to independence the firm has reason to believe are created by network firm interests and relationships.~~

~~*Multiple Responsible Parties*~~

~~900.21 A1 In some assurance engagements, whether assertion-based or direct reporting, there might be several responsible parties. In determining whether it is necessary to apply the provisions in this Part to each responsible party in such engagements, the firm may take into account certain matters. These matters include whether an interest or relationship between the firm, or an assurance team member, and a particular responsible party would create a threat to independence that is not trivial and inconsequential in the context of the subject matter information. This determination will take into account factors such as:~~

~~(a) The materiality of the subject matter information (or of the subject matter) for which the particular responsible party is responsible.~~

~~(b) The degree of public interest associated with the engagement.~~

~~If the firm determines that the threat created by any such interest or relationship with a particular responsible party would be trivial and inconsequential, it might not be necessary to apply all of the provisions of this section to that responsible party.~~

[Paragraphs 900.16~~22~~ to 900.29 are intentionally left blank]

Period During which Independence is Required

R900.30 Independence, as required by this Part, shall be maintained during both:

(a) The engagement period; and

(b) The period covered by the subject matter information.

900.30 A1 The engagement period starts when the assurance team begins to perform assurance services with respect to the particular engagement. The engagement period ends when the assurance report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final assurance report.

R900.31 If an entity becomes an assurance client during or after the period covered by the subject matter information on which the firm will express a conclusion, the firm shall determine whether any threats to independence are created by:

(a) Financial or business relationships with the assurance client during or after the period covered by the subject matter information but before accepting the assurance engagement; or

(b) Previous services provided to the assurance client.

R900.32 Threats to independence are created if a non-assurance service was provided to the assurance client during, or after the period covered by the subject matter information, but before the assurance team begins to perform assurance services, and the service would not be permitted during the engagement period. In such circumstances, the firm shall evaluate and address any threat to independence created by the service. If the threats are not at an acceptable level, the firm shall only accept the assurance engagement if the threats are reduced to an acceptable level.

900.32 A1 Examples of actions that might be safeguards to address such threats include:

- Using professionals who are not assurance team members to perform the service.
- Having an appropriate reviewer review the assurance and non-assurance work as appropriate.

R900.33 If a non-assurance service that would not be permitted during the engagement period has not been completed and it is not practical to complete or end the service before the commencement of professional services in connection with the assurance engagement, the firm shall only accept the assurance engagement if:

(a) The firm is satisfied that:

(i) The non-assurance service will be completed within a short period of time; or

(ii) The client has arrangements in place to transition the service to another provider within a short period of time;

(b) The firm applies safeguards when necessary during the service period; and

(c) The firm discusses the matter with those charged with governance.

[Paragraphs 900.34 to 900.39 are intentionally left blank]

General Documentation of Independence for Assurance Engagements ~~Other than Audit and Review Engagements~~

R900.40 A firm shall document conclusions regarding compliance with this Part, and the substance of any relevant discussions that support those conclusions. In particular:

(a) When safeguards are applied to address a threat, the firm shall document the nature of the threat and the safeguards in place or applied; and

(b) When a threat required significant analysis and the firm concluded that the threat was already at an acceptable level, the firm shall document the nature of the threat and the rationale for the conclusion.

900.40 A1 Documentation provides evidence of the firm's judgements in forming conclusions regarding compliance with this Part. However, a lack of documentation does not determine whether a firm considered a particular matter or whether the firm is independent.

[Paragraphs 900.41 to 900.49 are intentionally left blank]

Breach of an Independence Provision for Assurance Engagements ~~Other than Audit and Review Engagements~~

When a Firm Identifies a Breach

R900.50 If a firm concludes that a breach of a requirement in this Part has occurred, the firm shall:

(a) End, suspend or eliminate the interest or relationship that created the breach;

(b) Evaluate the significance of the breach and its impact on the firm's objectivity and ability to issue an assurance report; and

(c) Determine whether action can be taken that satisfactorily addresses the consequences of the breach.

In making this determination, the firm shall exercise professional judgement and take into account whether a reasonable and informed third party would be likely to conclude that the firm's objectivity would be compromised, and therefore, the firm would be unable to issue an assurance report.

R900.51 If the firm determines that action cannot be taken to address the consequences of the breach satisfactorily, the firm shall, as soon as possible, inform the party that engaged the firm or those charged with governance, as appropriate. The firm shall also take the steps necessary to end the assurance engagement in compliance with any applicable legal or regulatory requirements relevant to ending the assurance engagement.

R900.52 If the firm determines that action can be taken to address the consequences of the breach satisfactorily, the firm shall discuss the breach and the action it has taken or proposes to take with the party that engaged the firm or those charged with governance, as appropriate. The firm shall discuss the breach and the proposed action on a timely basis, taking into account the circumstances of the engagement and the breach.

R900.53 If the party that engaged the firm does not, or those charged with governance do not concur that the action proposed by the firm in accordance with paragraph R900.50(c) satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to end the assurance engagement in compliance with any applicable legal or regulatory requirements relevant to ending the assurance engagement.

Documentation

R900.54 In complying with the requirements in paragraphs R900.50 to R900.53, the firm shall document:

(a) The breach;

(b) The actions taken;

(c) The key decisions made; and

(d) All the matters discussed with the party that engaged the firm or those charged with governance.

R900.55 If the firm continues with the assurance engagement, it shall document:

(a) The conclusion that, in the firm's professional judgement, objectivity has not been compromised; and

(b) The rationale for why the action taken satisfactorily addressed the consequences of the breach so that the firm could issue an assurance report.

SECTION 905

FEES

Introduction

905.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

905.2 The nature and level of fees or other types of remuneration might create a self-interest or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Fees—Relative Size

NZ R905.3.1 As required by R120.10, where the threat cannot be eliminated or safeguards, where available and capable of being applied, cannot reduce the threat to an acceptable level, the firm shall end or decline the engagement.

905.3 A1 When the total fees generated from an assurance client by the firm expressing the conclusion in an assurance engagement represent a large proportion of the total fees of that firm, the dependence on that client and concern about losing the client create a self-interest or intimidation threat.

905.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The operating structure of the firm.
- Whether the firm is well established or new.
- The significance of the client qualitatively and/or quantitatively to the firm.

905.3 A3 An example of an action that might be a safeguard to address such a self-interest or intimidation threat is increasing the client base in the firm to reduce dependence on the assurance client.

905.3 A4 A self-interest or intimidation threat is also created when the fees generated by the firm from an assurance client represent a large proportion of the revenue from an individual partner's clients.

905.3 A5 Examples of actions that might be safeguards to address such a self-interest or intimidation threat include:

- Increasing the client base of the partner to reduce dependence on the assurance client.
- Having an appropriate reviewer who was not an assurance team member review the work.

Fees—Overdue

905.4 A1 A self-interest threat might be created if a significant part of fees is not paid before the assurance report, if any, for the following period is issued. It is generally expected that the firm will require payment of such fees before any such report is issued. The requirements and application material set out in Section 911 with respect to loans and guarantees might also apply to situations where such unpaid fees exist.

905.4 A2 Examples of actions that might be safeguards to address such a self-interest threat include:

- Obtaining partial payment of overdue fees.
- Having an appropriate reviewer who did not take part in the assurance engagement review the work performed.

R905.5 When a significant part of fees due from an assurance client remains unpaid for a long time, the firm shall determine:

(a) Whether the overdue fees might be equivalent to a loan to the client; and

(b) Whether it is appropriate for the firm to be re-appointed or continue the assurance engagement.

Contingent Fees

905.6 A1 Contingent fees are fees calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed. A contingent fee charged through an intermediary is an example of an indirect contingent fee. In this section, a fee is not regarded as being contingent if established by a court or other public authority.

R905.7 A firm shall not charge directly or indirectly a contingent fee for an assurance engagement.

R905.8 A firm shall not charge directly or indirectly a contingent fee for a non-assurance service provided to an assurance client if the outcome of the non-assurance service, and therefore, the amount of the fee, is dependent on a future or contemporary judgement related to a matter that is material to the subject matter information of the assurance engagement.

905.9 A1 Paragraphs R905.7 and R905.8 preclude a firm from entering into certain contingent fee arrangements with an assurance client. Even if a contingent fee arrangement is not precluded when providing a non-assurance service to an assurance client, a self-interest threat might still be created.

905.9 A2 Factors that are relevant in evaluating the level of such a threat include:

- The range of possible fee amounts.
- Whether an appropriate authority determines the outcome on which the contingent fee depends.
- Disclosure to intended users of the work performed by the firm and the basis of remuneration.
- The nature of the service.
- The effect of the event or transaction on the subject matter information.

905.9 A3 Examples of actions that might be safeguards to address such a self-interest threat include:

- Having an appropriate reviewer who was not involved in performing the non-assurance service review the relevant assurance work.
- Obtaining an advance written agreement with the client on the basis of remuneration.

SECTION 906

GIFTS AND HOSPITALITY

Introduction

906.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

906.2 Accepting gifts and hospitality from an assurance client might create a self-interest, familiarity or intimidation threat. This section sets out a specific requirement and application material relevant to applying the conceptual framework in such circumstances.

Requirement and Application Material

R906.3 A firm or an assurance team member shall not accept gifts and hospitality from an assurance client, unless the value is trivial and inconsequential.

906.3 A1 Where a firm or assurance team member is offering or accepting an inducement to or from an assurance client, the requirements and application material set out in Section 340 apply and non-compliance with these requirements might create threats to independence.

906.3 A2 The requirements set out in Section 340 relating to offering or accepting inducements do not allow a firm or assurance team member to accept gifts and hospitality where the intent is to improperly influence behaviour even if the value is trivial and inconsequential.

SECTION 907

ACTUAL OR THREATENED LITIGATION

Introduction

907.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

907.2 When litigation with an assurance client occurs, or appears likely, self-interest and intimidation threats are created. This section sets out specific application material relevant to applying the conceptual framework in such circumstances.

Application Material

General

907.3 A1 The relationship between client management and assurance team members must be characterised by complete candor and full disclosure regarding all aspects of a client's operations. Adversarial positions might result from actual or threatened litigation between an assurance client and the firm or an assurance team member. Such adversarial positions might affect management's willingness to make complete disclosures and create self-interest and intimidation threats.

907.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The materiality of the litigation.
- Whether the litigation relates to a prior assurance engagement.

907.3 A3 If the litigation involves an assurance team member, an example of an action that might eliminate such self-interest and intimidation threats is removing that individual from the assurance team.

907.3 A4 An example of an action that might be a safeguard to address such self-interest and intimidation threats is having an appropriate reviewer review the work performed.

SECTION 910

FINANCIAL INTERESTS

Introduction

910.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

910.2 Holding a financial interest in an assurance client might create a self-interest threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

910.3 A1 A financial interest might be held directly or indirectly through an intermediary such as a collective investment vehicle, an estate or a trust. When a beneficial owner has control over the intermediary or ability to influence its investment decisions, the Code defines that financial interest to be direct. Conversely, when a beneficial owner has no control over the intermediary or ability to influence its investment decisions, the Code defines that financial interest to be indirect.

910.3 A2 This section contains references to the “materiality” of a financial interest. In determining whether such an interest is material to an individual, the combined net worth of the individual and the individual’s immediate family members may be taken into account.

910.3 A3 Factors that are relevant in evaluating the level of a self-interest threat created by holding a financial interest in an assurance client include:

- The role of the individual holding the financial interest.
- Whether the financial interest is direct or indirect.
- The materiality of the financial interest.

Financial Interests Held by the Firm, Assurance Team Members and Immediate Family

R910.4 A direct financial interest or a material indirect financial interest in the assurance client shall not be held by:

(a) The firm; or

(b) An assurance team member or any of that individual’s immediate family.

Financial Interests in an Entity Controlling an Assurance Client

R910.5 When an entity has a controlling interest in the assurance client and the client is material to the entity, neither the firm, nor an assurance team member, nor any of that individual’s immediate family shall hold a direct or material indirect financial interest in that entity.

Financial Interests Held as Trustee

R910.6 Paragraph R910.4 shall also apply to a financial interest in an assurance client held in a trust for which the firm or individual acts as trustee unless:

- **(a)** None of the following is a beneficiary of the trust: the trustee, the assurance team member or any of that individual's immediate family, or the firm;
- **(b)** The interest in the assurance client held by the trust is not material to the trust;
- **(c)** The trust is not able to exercise significant influence over the assurance client; and
- **(d)** None of the following can significantly influence any investment decision involving a financial interest in the assurance client: the trustee, the assurance team member or any of that individual's immediate family, or the firm.

Financial Interests Received Unintentionally

R910.7 If a firm, an assurance team member, or any of that individual's immediate family, receives a direct financial interest or a material indirect financial interest in an assurance client by way of an inheritance, gift, as a result of a merger, or in similar circumstances and the interest would not otherwise be permitted to be held under this section, then:

- **(a)** If the interest is received by the firm, the financial interest shall be disposed of immediately, or enough of an indirect financial interest shall be disposed of so that the remaining interest is no longer material; or
- **(b)** If the interest is received by an assurance team member, or by any of that individual's immediate family, the individual who received the financial interest shall immediately dispose of the financial interest, or dispose of enough of an indirect financial interest so that the remaining interest is no longer material.

Financial Interests – Other Circumstances

Close Family

910.8 A1 A self-interest threat might be created if an assurance team member knows that a close family member has a direct financial interest or a material indirect financial interest in the assurance client.

910.8 A2 Factors that are relevant in evaluating the level of such a threat include:

- The nature of the relationship between the assurance team member and the close family member.
- Whether the financial interest is direct or indirect.
- The materiality of the financial interest to the close family member.

910.8 A3 Examples of actions that might eliminate such a self-interest threat include:

- Having the close family member dispose, as soon as practicable, of all of the financial interest or dispose of enough of an indirect financial interest so that the remaining interest is no longer material.

- Removing the individual from the assurance team.

910.8 A4 An example of an action that might be a safeguard to address such a self-interest threat is having an appropriate reviewer review the work of the assurance team member.

Other Individuals

910.8 A5 A self-interest threat might be created if an assurance team member knows that a financial interest is held in the assurance client by individuals such as:

- Partners and professional employees of the firm, apart from those who are specifically not permitted to hold such financial interests by paragraph R910.4, or their immediate family members.
- Individuals with a close personal relationship with an assurance team member.

910.8 A6 An example of an action that might eliminate such a self-interest threat is removing the assurance team member with the personal relationship from the assurance team.

910.8 A7 Examples of actions that might be safeguards to address such a self-interest threat include:

- Excluding the assurance team member from any significant decision-making concerning the assurance engagement.
- Having an appropriate reviewer review the work of the assurance team member.

SECTION 911

LOANS AND GUARANTEES

Introduction

911.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

911.2 A loan or a guarantee of a loan with an assurance client might create a self-interest threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

911.3 A1 This section contains references to the "materiality" of a loan or guarantee. In determining whether such a loan or guarantee is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

Loans and Guarantees with an Assurance Client

R911.4 A firm, an assurance team member, or any of that individual's immediate family shall not make or guarantee a loan to an assurance client unless the loan or guarantee is immaterial to both:

- **(a)** The firm or the individual making the loan or guarantee, as applicable; and
- **(b)** The client.

Loans and Guarantees with an Assurance Client that is a Bank or Similar Institution

R911.5 A firm, an assurance team member, or any of that individual's immediate family shall not accept a loan, or a guarantee of a loan, from an assurance client that is a bank or a similar institution unless the loan or guarantee is made under normal lending procedures, terms and conditions.

911.5 A1 Examples of loans include mortgages, bank overdrafts, car loans and credit card balances.

911.5 A2 Even if a firm receives a loan from an assurance client that is a bank or similar institution under normal lending procedures, terms and conditions, the loan might create a self-interest threat if it is material to the assurance client or firm receiving the loan.

911.5 A3 An example of an action that might be a safeguard to address such a self-interest threat is having the work reviewed by an appropriate reviewer, who is not an assurance team member, from a network firm that is not a beneficiary of the loan.

Deposit or Brokerage Accounts

R911.6 A firm, an assurance team member, or any of that individual's immediate family shall not have deposits or a brokerage account with an assurance client that is a bank, broker, or similar institution, unless the deposit or account is held under normal commercial terms.

Loans and Guarantees with an Assurance Client that is not a Bank or Similar Institution

R911.7 A firm or an assurance team member, or any of that individual's immediate family, shall not accept a loan from, or have a borrowing guaranteed by, an assurance client that is not a bank or similar institution, unless the loan or guarantee is immaterial to both:

(a) The firm, or the individual receiving the loan or guarantee, as applicable; and

(b) The client.

SECTION 920

BUSINESS RELATIONSHIPS

Introduction

920.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

920.2 A close business relationship with an assurance client or its management might create a self-interest or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

920.3 A1 This section contains references to the "materiality" of a financial interest and the "significance" of a business relationship. In determining whether such a financial interest is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

920.3 A2 Examples of a close business relationship arising from a commercial relationship or common financial interest include:

- Having a financial interest in a joint venture with either the assurance client or a controlling owner, director or officer or other individual who performs senior managerial activities for that client.
- Arrangements to combine one or more services or products of the firm with one or more services or products of the client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm distributes or markets the client's products or services, or the client distributes or markets the firm's products or services.

Firm, Assurance Team Member or Immediate Family Business Relationships

R920.4 A firm or an assurance team member shall not have a close business relationship with an assurance client or its management unless any financial interest is immaterial and the business relationship is insignificant to the client or its management and the firm or the assurance team member, as applicable.

920.4 A1 A self-interest or intimidation threat might be created if there is a close business relationship between the assurance client or its management and the immediate family of an assurance team member.

Buying Goods or Services

920.5 A1 The purchase of goods and services from an assurance client by a firm, or an assurance team member, or any of that individual's immediate family does not usually create a threat to independence if the transaction is in the normal course of business and at arm's length. However, such transactions might be of such a nature and magnitude that they create a self-interest threat.

920.5 A2 Examples of actions that might eliminate such a self-interest threat include:

- Eliminating or reducing the magnitude of the transaction.
- Removing the individual from the assurance team.

SECTION 921

FAMILY AND PERSONAL RELATIONSHIPS

Introduction

921.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

921.2 Family or personal relationships with client personnel might create a self-interest, familiarity or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

921.3 A1 A self-interest, familiarity or intimidation threat might be created by family and personal relationships between an assurance team member and a director or officer or, depending on their role, certain employees of the assurance client.

921.3 A2 Factors that are relevant in evaluating the level of such threats include:

- The individual's responsibilities on the assurance team.
- The role of the family member or other individual within the assurance client, and the closeness of the relationship.

Immediate Family of an Assurance Team Member

921.4 A1 A self-interest, familiarity or intimidation threat is created when an immediate family member of an assurance team member is an employee in a position to exert significant influence over the underlying subject matter of the assurance engagement.

921.4 A2 Factors that are relevant in evaluating the level of such threats include:

- The position held by the immediate family member.
- The role of the assurance team member.

921.4 A3 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the assurance team.

921.4 A4 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the assurance team so that the assurance team member does not deal with matters that are within the responsibility of the immediate family member.

R921.5 An individual shall not participate as an assurance team member when any of that individual's immediate family:

(a) Is a director or officer of the assurance client;

(b) Is an employee in a position to exert significant influence over the subject matter information of the assurance engagement; or

(c) Was in such a position during any period covered by the engagement or the subject matter information.

Close Family of an Assurance Team Member

921.6 A1 A self-interest, familiarity or intimidation threat is created when a close family member of an assurance team member is:

(a) A director or officer of the assurance client; or

(b) An employee in a position to exert significant influence over the underlying subject matter or, in an attestation engagement, an employee in a position to exert significant influence over the subject matter information of the assurance engagement.

921.6 A2 Factors that are relevant in evaluating the level of such threats include:

- The nature of the relationship between the assurance team member and the close family member.
- The position held by the close family member.
- The role of the assurance team member.

921.6 A3 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the assurance team.

921.6 A4 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the assurance team so that the assurance team member does not deal with matters that are within the responsibility of the close family member.

Other Close Relationships of an Assurance Team Member

R921.7 An assurance team member shall consult in accordance with firm policies and procedures if the assurance team member has a close relationship with an individual who is not an immediate or close family member, but who is:

(a) A director or officer of the assurance client; or

(b) An employee in a position to exert significant influence over the underlying subject matter or, in an attestation engagement, an employee in a position to exert significant influence over the subject matter information of the assurance engagement.

921.7 A1 Factors that are relevant in evaluating the level of a self-interest, familiarity or intimidation threat created by such relationships include:

- The nature of the relationship between the individual and the assurance team member.
- The position the individual holds with the client.
- The role of the assurance team member.

921.7 A2 An example of an action that might eliminate such a self-interest, familiarity or intimidation threat is removing the individual from the assurance team.

921.7 A3 An example of an action that might be a safeguard to address such a self-interest, familiarity or intimidation threat is structuring the responsibilities of the assurance team so that the assurance team member does not deal with matters that are within the responsibility of the individual with whom the assurance team member has a close relationship.

Relationships of Partners and Employees of the Firm

921.8 A1 A self-interest, familiarity or intimidation threat might be created by a personal or family relationship between:

(a) A partner or employee of the firm who is not an assurance team member; and

(b) Any of the following individuals at the assurance client:

i. A director or officer;

~~i.~~ii. ~~of the assurance client or~~ An employee in a position to exert significant influence over the underlying subject matter or an employee in a position to exert significant influence over the subject matter information of the assurance engagement.

921.8 A2 Factors that are relevant in evaluating the level of such threats include:

- The nature of the relationship between the partner or employee of the firm and the director or officer or employee of the client.
- The degree of interaction of the partner or employee of the firm with the assurance team.
- The position of the partner or employee within the firm.
- The role of the individual within the client.

921.8 A3 Examples of actions that might be safeguards to address such self-interest, familiarity or intimidation threats include:

- Structuring the partner's or employee's responsibilities to reduce any potential influence over the assurance engagement.
- Having an appropriate reviewer review the relevant assurance work performed.

SECTION 922

RECENT SERVICE WITH AN ASSURANCE CLIENT

Introduction

922.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

922.2 If an assurance team member has recently served as a director or officer or employee of the assurance client, a self-interest, self-review or familiarity threat might be created. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Service During the Period Covered by the Assurance Report

R922.3 The assurance team shall not include an individual who, during the period covered by the assurance report:

(a) Had served as a director or officer of the assurance client; or

(b) Was an employee in a position to exert significant influence over underlying subject matter or, in an attestation engagement, employee in a position to exert significant influence over the subject matter information of the assurance engagement.

Service Prior to the Period Covered by the Assurance Report

922.4 A1 A self-interest, self-review or familiarity threat might be created if, before the period covered by the assurance report, an assurance team member:

(a) Had served as a director or officer of the assurance client; or

(b) Was an employee in a position to exert significant influence over underlying subject matter or, in an attestation engagement, employee in a position to exert significant influence over the subject matter information of the assurance engagement.

For example, a threat would be created if a decision made or work performed by the individual in the prior period, while employed by the client, is to be evaluated in the current period as part of the current assurance engagement.

922.4 A2 Factors that are relevant in evaluating the level of such threats include:

- The position the individual held with the client.
- The length of time since the individual left the client.
- The role of the assurance team member.

922.4 A3 An example of an action that might be a safeguard to address such a self-interest, self-review or familiarity threat is having an appropriate reviewer review the work performed by the assurance team member.

SECTION 923

SERVING AS A DIRECTOR OR OFFICER OF AN ASSURANCE CLIENT

Introduction

923.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

923.2 Serving as a director or officer of an assurance client creates self-review and self-interest threats. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

Service as Director or Officer

R923.3 A partner or employee of the firm shall not serve as a director or officer of an assurance client of the firm.

Service as Company Secretary

R923.4 A partner or employee of the firm shall not serve as Company Secretary for an assurance client of the firm unless:

(a) This practice is specifically permitted under local law, professional rules or practice;

(b) Management makes all decisions; and

(c) The duties and activities performed are limited to those of a routine and administrative nature, such as preparing minutes and maintaining statutory returns.

923.4 A1 The position of Company Secretary has different implications in different jurisdictions. Duties might range from: administrative duties (such as personnel management and the maintenance of company records and registers) to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Usually this position is seen to imply a close association with the entity. Therefore, a threat is created if a partner or employee of the firm serves as Company Secretary for an assurance client. (More information on providing non-assurance services to an assurance client is set out in Section 950, *Provision of Non-assurance~~s~~ Services to an Assurance Client.)*

SECTION 924

EMPLOYMENT WITH AN ASSURANCE CLIENT

Introduction

924.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

924.2 Employment relationships with an assurance client might create a self-interest, familiarity or intimidation threat. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

924.3 A1 A familiarity or intimidation threat might be created if any of the following individuals have been an assurance team member or partner of the firm:

- A director or officer of the assurance client.
- An employee in a position to exert significant influence over the underlying subject matter or, in an attestation engagement, an employee who is in a position to exert significant influence over the subject matter information of the assurance engagement.

Former Partner or Assurance Team Member Restrictions

R924.4 If a former partner has joined an assurance client of the firm or a former assurance team member has joined the assurance client as:

(a) A director or officer; or

(b) An employee in a position to exert significant influence over the underlying subject matter or, in an attestation engagement, an employee in a position to exert significant influence over the subject matter information of the assurance engagement, the individual shall not continue to participate in the firm's business or professional activities.

~~the individual shall not continue to participate in the firm's business or professional activities.~~

924.4 A1 Even if one of the individuals described in paragraph R924.4 has joined the assurance client in such a position and does not continue to participate in the firm's business or professional activities, a familiarity or intimidation threat might still be created.

924.4 A2 A familiarity or intimidation threat might also be created if a former partner of the firm has joined an entity in one of the positions described in paragraph 924.3 A1 and the entity subsequently becomes an assurance client of the firm.

924.4 A3 Factors that are relevant in evaluating the level of such threats include:

- The position the individual has taken at the client.

- Any involvement the individual will have with the assurance team.
- The length of time since the individual was an assurance team member or partner of the firm.
- The former position of the individual within the assurance team or firm. An example is whether the individual was responsible for maintaining regular contact with the client's management or those charged with governance.

924.4 A4 Examples of actions that might be safeguards to address such a familiarity or intimidation threat include:

- Making arrangements such that the individual is not entitled to any benefits or payments from the firm, unless made in accordance with fixed pre-determined arrangements.
- Making arrangements such that any amount owed to the individual is not material to the firm.
- Modifying the plan for the assurance engagement.
- Assigning to the assurance team individuals who have sufficient experience relative to the individual who has joined the client.
- Having an appropriate reviewer review the work of the former assurance team member.

Assurance Team Members Entering Employment Negotiations with a Client

R924.5 A firm shall have policies and procedures that require assurance team members to notify the firm when entering employment negotiations with an assurance client.

924.5 A1 A self-interest threat is created when an assurance team member participates in the assurance engagement while knowing that the assurance team member will, or might, join the client sometime in the future.

924.5 A2 An example of an action that might eliminate such a self-interest threat is removing the individual from the assurance engagement.

924.5 A3 An example of an action that might be a safeguard to address such a self-interest threat is having an appropriate reviewer review any significant judgements made by that assurance team member while on the team.

SECTION 940

LONG ASSOCIATION OF PERSONNEL WITH AN ASSURANCE CLIENT

Introduction

940.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

940.2 When an individual is involved in an assurance engagement of a recurring nature over a long period of time, familiarity and self-interest threats might be created. This section sets out requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

940.3 A1 A familiarity threat might be created as a result of an individual's long association with:

(a) The assurance client;

(b) The assurance client's senior management; or

(c) The underlying subject matter ~~and~~ or, in an attestation engagement, subject matter information of the assurance engagement.

940.3 A2 A self-interest threat might be created as a result of an individual's concern about losing a longstanding assurance client or an interest in maintaining a close personal relationship with a member of senior management or those charged with governance. Such a threat might influence the individual's judgement inappropriately.

940.3 A3 Factors that are relevant to evaluating the level of such familiarity or self-interest threats include:

- The nature of the assurance engagement.
- How long the individual has been an assurance team member, the individual's seniority on the team, and the nature of the roles performed, including if such a relationship existed while the individual was at a prior firm.
- The extent to which the work of the individual is directed, reviewed and supervised by more senior personnel.
- The extent to which the individual, due to the individual's seniority, has the ability to influence the outcome of the assurance engagement, for example, by making key decisions or directing the work of other engagement team members.
- The closeness of the individual's personal relationship with the assurance client or, if relevant, senior management.
- The nature, frequency and extent of interaction between the individual and the assurance client.
- Whether the nature or complexity of the underlying subject matter or subject matter information has changed.

- Whether there have been any recent changes in the individual or individuals at the assurance client who are ~~the~~ responsible for the underlying subject matter or, in an attestation engagement, the subject matter information ~~party~~ or, if relevant, senior management.

940.3 A4 The combination of two or more factors might increase or reduce the level of the threats. For example, familiarity threats created over time by the increasingly close relationship between an ~~individual~~ assurance team member and an individual at ~~and~~ the assurance client who is in a position to exert significant influence over the underlying subject matter or, in an attestation engagement, the subject matter information, would be reduced by the departure of ~~the~~ that individual from the client. ~~who is the responsible party.~~

940.3 A5 An example of an action that might eliminate the familiarity and self-interest threats in relation to a specific engagement would be rotating the individual off the assurance team.

940.3 A6 Examples of actions that might be safeguards to address such familiarity or self-interest threats include:

- Changing the role of the individual on the assurance team or the nature and extent of the tasks the individual performs.
- Having an appropriate reviewer who was not an assurance team member review the work of the individual.
- Performing regular independent internal or external quality reviews of the engagement.

R940.4 If a firm decides that the level of the threats created can only be addressed by rotating the individual off the assurance team, the firm shall determine an appropriate period during which the individual shall not:

(a) Be a member of the engagement team for the assurance engagement;

(b) Provide quality control for the assurance engagement; or

(c) Exert direct influence on the outcome of the assurance engagement.

The period shall be of sufficient duration to allow the familiarity and self-interest threats to be addressed.

SECTION 950

PROVISION OF NON-ASSURANCE SERVICES TO ASSURANCE CLIENTS~~ OTHER THAN AUDIT AND REVIEW ENGAGEMENT CLIENTS~~

Introduction

950.1 Firms are required to comply with the fundamental principles, be independent, and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

950.2 Firms might provide a range of non-assurance services to their assurance clients, consistent with their skills and expertise. Providing certain non-assurance services to assurance clients might create threats to compliance with the fundamental principles and threats to independence. This section sets out specific requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

General

R950.3 Before a firm accepts an engagement to provide a non-assurance service to an assurance client, the firm shall determine whether providing such a service might create a threat to independence.

950.3 A1 The requirements and application material in this section assist firms in analysing certain types of non-assurance services and the related threats that might be created when a firm accepts or provides non-assurance services to an assurance client.

950.3 A2 New business practices, the evolution of financial markets and changes in information technology are among the developments that make it impossible to draw up an all-inclusive list of non-assurance services that might be provided to an assurance client. As a result, the Code does not include an exhaustive listing of all non-assurance services that might be provided to an assurance client.

Evaluating Threats

950.4 A1 Factors that are relevant in evaluating the level of threats created by providing a non-assurance service to an assurance client include:

- The nature, scope and purpose of the service.
- The degree of reliance that will be placed on the outcome of the service as part of the assurance engagement.
- The legal and regulatory environment in which the service is provided.
- Whether the outcome of the service will affect the underlying subject matter and, in an attestation engagement, matters reflected in the ~~subject matter or~~ subject matter information of the assurance engagement, and, if so:
    - o The extent to which the outcome of the service will have a material or significant effect on the underlying subject matter and, in an attestation engagement, the subject matter information of the assurance engagement.
    - o The extent of the assurance client's involvement in determining significant

matters of judgement.

- The level of expertise of the client's management and employees with respect to the type of service provided.

Materiality in Relation to an Assurance Client's Information

950.4 A2 The concept of materiality in relation to an assurance client's subject matter information is addressed in *International Standard on Assurance Engagements (New Zealand) (ISAE (NZ)) 3000 (Revised), Assurance Engagements other than Audits or Reviews of Historical Financial Information*. The determination of materiality involves the exercise of professional judgement and is impacted by both quantitative and qualitative factors. It is also affected by perceptions of the financial or other information needs of users.

Multiple Non-assurance Services Provided to the Same Assurance Client

950.4 A3 A firm might provide multiple non-assurance services to an assurance client. In these circumstances the combined effect of threats created by providing those services is relevant to the firm's evaluation of threats.

Addressing Threats

950.5 A1 Paragraph 120.10 A2 includes a description of safeguards. In relation to providing non-assurance services to assurance clients, safeguards are actions, individually or in combination, that the firm takes that effectively reduce threats to independence to an acceptable level. In some situations, when a threat is created by providing a service to an assurance client, safeguards might not be available. In such situations, the application of the conceptual framework set out in Section 120 requires the firm to decline or end the non-assurance service or the assurance engagement.

Prohibition on Assuming Management Responsibilities

R950.6 A firm shall not assume a management responsibility related to the underlying subject matter and, in an attestation engagement, the ~~or~~ subject matter information of an assurance engagement provided by the firm. If the firm assumes a management responsibility as part of any other service provided to the assurance client, the firm shall ensure that the responsibility is not related to the underlying subject matter and, in an attestation engagement, ~~or~~ the subject matter information of the assurance engagement provided by the firm.

950.6 A1 Management responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources.

950.6 A2 Providing a non-assurance service to an assurance client creates self-review and self-interest threats if the firm assumes a management responsibility when performing the service. In relation to providing a service related to the underlying subject matter and, in an attestation engagement, ~~or~~ the subject matter information of an assurance engagement provided by the firm, assuming a management responsibility also creates a familiarity threat and might create an advocacy threat because the firm becomes too closely aligned with the views and interests of management.

950.6 A3 Determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of professional judgement. Examples of activities that would be considered a management responsibility include:

- Setting policies and strategic direction.
- Hiring or dismissing employees.
- Directing and taking responsibility for the actions of employees in relation to the employees' work for the entity.
- Authorising transactions.
- Controlling or managing bank accounts or investments.
- Deciding which recommendations of the firm or other third parties to implement.
- Reporting to those charged with governance on behalf of management.
- Taking responsibility for designing, implementing, monitoring and maintaining internal control.

950.6 A4 Providing advice and recommendations to assist the management of an assurance client in discharging its responsibilities is not assuming a management responsibility. (Ref: Paras. R950.6 to 950.6 A3).

R950.7 To avoid assuming a management responsibility when providing non-assurance services to an assurance client that are related to the underlying subject matter and, in an attestation engagement, the ~~or~~ subject matter information of the assurance engagement, the firm shall be satisfied that client management makes all related judgements and decisions that are the proper responsibility of management. This includes ensuring that the client's management:

(a) Designates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client's decisions and to oversee the services. Such an individual, preferably within senior management, would understand:

(i) The objectives, nature and results of the services; and

(ii) The respective client and firm responsibilities.

However, the individual is not required to possess the expertise to perform or re-perform the services.

(b) Provides oversight of the services and evaluates the adequacy of the results of the service performed for the client's purpose; and

(c) Accepts responsibility for the actions, if any, to be taken arising from the results of the services.

Other Considerations Related to Providing Specific Non-Assurance Services

950.8 A1 A self-review threat might be created if, in an attestation engagement, the firm is involved in the preparation of subject matter information which ~~is~~ subsequently becomes the subject matter information of an assurance engagement. Examples of non-assurance services that might create such self-review threats when providing services related to the subject matter information of an assurance engagement include:

(a) Developing and preparing prospective information and subsequently ~~providing~~ issuing an assurance report on this information.

(b) Performing a valuation that is related to or forms part of the subject matter information of an assurance engagement.

SECTION 990

REPORTS THAT INCLUDE A RESTRICTION ON USE AND DISTRIBUTION (ASSURANCE ENGAGEMENTS OTHER THAN AUDIT AND REVIEW ENGAGEMENTS)

Introduction

990.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

990.2 This section sets out certain modifications to Part 4B which are permitted in certain circumstances involving assurance engagements where the report includes a restriction on use and distribution. In this section, an engagement to issue a restricted use and distribution assurance report in the circumstances set out in paragraph R990.3 is referred to as an "eligible assurance engagement."

Requirements and Application Material

General

R990.3 When a firm intends to issue a report on an assurance engagement which includes a restriction on use and distribution, the independence requirements set out in Part 4B shall be eligible for the modifications that are permitted by this section, but only if:

(a) The firm communicates with the intended users of the report regarding the modified independence requirements that are to be applied in providing the service; and

(b) The intended users of the report understand the purpose, subject matter information and limitations of the report and explicitly agree to the application of the modifications.

990.3 A1 The intended users of the report might obtain an understanding of the purpose, subject matter information, and limitations of the report by participating, either directly, or indirectly through a representative who has authority to act for the intended users, in establishing the nature and scope of the engagement. In either case, this participation helps the firm to communicate with intended users about independence matters, including the circumstances that are relevant to applying the conceptual framework. It also allows the firm to obtain the agreement of the intended users to the modified independence requirements.

R990.4 Where the intended users are a class of users who are not specifically identifiable by name at the time the engagement terms are established, the firm shall subsequently make such users aware of the modified independence requirements agreed to by their representative.

990.4 A1 For example, where the intended users are a class of users such as lenders in a syndicated loan arrangement, the firm might describe the modified independence requirements in an engagement letter to the representative of the lenders. The representative might then make the firm's engagement letter available to the members of the group of lenders to meet the requirement for the firm to make such users aware of the modified independence requirements agreed to by the representative.

R990.5 When the firm performs an eligible assurance engagement, any modifications to Part 4B shall be limited to those modifications set out in paragraphs R990.7 and R990.8.

R990.6 If the firm also issues an assurance report that does not include a restriction on use and distribution for the same client, the firm shall apply Part 4B to that assurance engagement.

Financial Interests, Loans and Guarantees, Close Business, Family and Personal Relationships

R990.7 When the firm performs an eligible assurance engagement:

- **(a)** The relevant provisions set out in Sections 910, 911, 920, 921, 922 and 924 need apply only to the members of the engagement team, and their immediate and close family members;
- **(b)** The firm shall identify, evaluate and address any threats to independence created by interests and relationships, as set out in Sections 910, 911, 920, 921, 922 and 924, between the assurance client and the following assurance team members;
  - **(i)** Those who provide consultation regarding technical or industry specific issues, transactions or events; and
  - **(ii)** Those who provide quality control for the engagement, including those who perform the engagement quality control review; and
- **(c)** The firm shall evaluate and address any threats that the engagement team has reason to believe are created by interests and relationships between the assurance client and others within the firm who can directly influence the outcome of the assurance engagement, as set out in Sections 910, 911, 920, 921, 922 and 924.

990.7 A1 Others within the firm who can directly influence the outcome of the assurance engagement include those who recommend the compensation, or who provide direct supervisory, management or other oversight, of the assurance engagement partner in connection with the performance of the assurance engagement.

R990.8 When the firm performs an eligible assurance engagement, the firm shall not hold a material direct or a material indirect financial interest in the assurance client.

GLOSSARY

In the *International Code of Ethics for Professional Accountants (including International Independence Standards)*, the singular shall be construed as including the plural as well as the reverse, and the terms below have the following meanings assigned to them.

In this Glossary, explanations of defined terms are shown in regular font; italics are used for explanations of described terms which have a specific meaning in certain parts of the Code or for additional explanations of defined terms. References are also provided to terms described in the Code.

Acceptable level	A level at which an assurance practitioner using the reasonable and informed third party test would likely conclude that the assurance practitioner complies with the fundamental principles.
Advertising	The communication to the public of information as to the services or skills provided by assurance practitioners with a view to procuring assurance business.
Appropriate reviewer	*An appropriate reviewer is a professional with the necessary knowledge, skills, experience and authority to review, in an objective manner, the relevant work performed or service provided. Such an individual might be an assurance practitioner.* *This term is described in paragraph 300.8 A4.*
~~[NZ] Assurance client~~	~~An entity in respect of which a firm conducts an assurance engagement.~~
Assurance client	The responsible party and also, in an attestation engagement, the party taking responsibility for the subject matter information (who might be the same as the responsible party).
Assurance engagement	An engagement in which an assurance practitioner aims to obtain sufficient appropriate evidence in or to express~~es~~ a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the subject matter information (that is, the outcome of the ~~evaluation or~~ measurement or evaluation of an underlying subject matter against criteria). (ISAE (NZ) 3000 (Revised) ~~For guidance on assurance engagements, see the Explanatory Guide (EG) Au1 *Overview of Auditing and Assurance Standards*. EG Au1~~ describes the elements and objectives of an assurance engagement conducted under that Standard and Explanatory Guide (EG) Au1 *Overview of Auditing and Assurance Standards* provides a general description of assurance engagements to which ~~and identifies engagements to which~~ *International Standards on Auditing (New Zealand)* (ISAs (NZ)), *International Standards on Review Engagements (New Zealand)* (ISREs (NZ)), New Zealand Standard on Review Engagements (NZ SRE), *International Standards on Assurance*

Engagements (New Zealand) (ISAEs (NZ)), and Standards on Assurance Engagements (SAEs) apply.)

In Part 4B, the term 'assurance engagement' refers to assurance engagements that are not audit or review engagements.

[NZ] Assurance practitioner — A person or organisation, whether in public practice, industry, commerce or the public sector, appointed or engaged to undertake assurance engagements.

[NZ] Assurance services — Comprise of any assurance engagements performed by an assurance practitioner.

Assurance team —
(a) All members of the engagement team for the assurance engagement;
(b) All others within a firm who can directly influence the outcome of the assurance engagement, including:
   (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement partner in connection with the performance of the assurance engagement;
   (ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement; and
   (iii) Those who provide quality control for the assurance engagement, including those who perform the engagement quality control review for the assurance engagement.

Attestation engagement — An assurance engagement in which a party other than the assurance practitioner measures or evaluates the underlying subject matter against the criteria. A party other than the assurance practitioner also often presents the resulting subject matter in formation in a report or statement. In some cases, however, the subject matter information may be presented by the assurance practitioner in the assurance report. In an attestation engagement, the assurance practitioner's conclusion addresses whether the subject matter information is free from material misstatement. The assurance practitioner's conclusion may be phrased in terms of:

(a) The underlying subject matter and the applicable criteria;

(b) The subject matter information and the applicable criteria; or

(c) A statement made by the appropriate party(ies).

[NZ] Audit client — An entity in respect of which a firm conducts an audit engagement. When the client is a FMC reporting entity considered to have a higher level of public accountability, audit client will always include its related entities. When the audit client is not a FMC reporting entity considered to have a higher level of public accountability, audit client includes those related entities over which the client has direct or indirect control. *(See also paragraph R400.20.)*

Audit engagement

A reasonable assurance engagement in which an assurance practitioner expresses an opinion whether financial statements are prepared, in all material respects (or give a true and fair view or are presented fairly, in all material respects), in accordance with an applicable financial reporting framework, such as an engagement conducted in accordance with *International Standards on Auditing (New Zealand)*. This includes a Statutory Audit, which is an audit required by legislation or other regulation.

Audit team

(a) All members of the engagement team for the audit engagement;

(b) All others within a firm who can directly influence the outcome of the audit engagement, including:

  (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the audit engagement, including those at all successively senior levels above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent);

  (ii) Those who provide consultation regarding technical or industry-specific issues, transactions or events for the engagement; and

  (iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and

(c) All those within a network firm who can directly influence the outcome of the audit engagement.

Close family

A parent, child or sibling who is not an immediate family member.

Conceptual framework

This term is described in Section 120.

Contingent fee

A fee calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm. A fee that is established by a court or other public authority is not a contingent fee.

Cooling-off period

This term is described in paragraph R540.5 for the purposes of paragraphs R540.11 to R540.19.

Criteria

In an assurance engagement, the benchmarks used to measure or evaluate the underlying subject matter. The "applicable criteria" are the criteria used for the particular engagement.

Direct engagement

An assurance engagement in which the assurance practitioner measures or evaluates the underlying subject matter against the applicable criteria and the assurance practitioner presents the resulting subject matter information as part of, or accompanying, the assurance report. In a direct engagement, the assurance practitioner's conclusion addresses the reported outcome of the measurement or evaluation of the underlying subject matter against the criteria.

Direct financial interest

A financial interest:

(a) Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or

(b) Beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control, or the ability to influence investment decisions.

Director or officer

Those charged with the governance of an entity, or acting in an equivalent capacity, regardless of their title, which might vary from jurisdiction to jurisdiction.

Eligible audit engagement

This term is described in paragraph 800.2 for the purposes of Section 800.

Eligible assurance engagement

This term is described in paragraph 990.2 for the purposes of Section 990.

Engagement partner[3]

The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

Engagement period

(Audit and Review Engagements)

The engagement period starts when the audit or review team begins to perform the audit or review. The engagement period ends when the audit or review report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final audit or review report.

Engagement period

(Assurance Engagements Other

The engagement period starts when the assurance team begins to perform assurance services with respect to the particular engagement. The engagement period ends when the assurance report is issued. When the engagement is of a recurring nature, it ends at the later of the notification

[3] Engagement partner: should be read as referring to their public sector equivalents where relevant.

than Audit and Review Engagements)	by either party that the professional relationship has ended or the issuance of the final assurance report.
Engagement quality control review	A process designed to provide an objective evaluation, on or before the report is issued, of the significant judgements the engagement team made and the conclusions it reached in formulating the report.
Engagement team	All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or by a network firm. The term "engagement team" also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013), *Using the Work of Internal Auditors.*
Existing accountant	An accountant currently holding an audit appointment or carrying out accounting, tax, consulting or similar non-assurance services for a client.
External expert	An individual (who is not a partner or a member of the professional staff, including temporary staff, of the firm or a network firm) or organisation possessing skills, knowledge and experience in a field other than accounting or auditing, whose work in that field is used to assist the assurance practitioner in obtaining sufficient appropriate evidence.
Financial interest	An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.
Financial statements	A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term can relate to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes. *The term does not refer to specific elements, accounts or items of a financial statement.*
Financial statements on which the firm will express an opinion	In the case of a single entity, the financial statements of that entity. In the case of consolidated financial statements, also referred to as group financial statements, the consolidated financial statements.
Firm	(a) A sole practitioner, partnership or corporation undertaking assurance engagements;

(b) An entity that controls such parties, through ownership, management or other means; and

(c) An entity controlled by such parties, through ownership, management or other means.

Paragraphs 400.4 and 900.3 explain how the word "firm" is used to address the responsibility of professional accountants and firms for compliance with Parts 4A and 4B, respectively.

[NZ] FMC reporting entity considered to have a higher level of public accountability

A FMC reporting entity of a class of FMC reporting entity that is considered to have a higher level of public accountability than other FMC reporting entities:

- Under section 461K of the Financial Markets Conduct Act 2013; or
- By notice issued by the Financial Markets Authority under section 461L(1)(1) of the Financial Markets Conduct Act 2013.

Fundamental principles

This term is described in paragraph 110.1 A1. Each of the fundamental principles is, in turn, described in the following paragraphs:

Integrity	*R111.1*
Objectivity	*R112.1*
Professional competence and due care	*R113.1*
Confidentiality	*R114.1*
Professional behaviour	*R115.1*

Historical financial information

Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Immediate family

A spouse (or equivalent) or dependent.

Independence

Independence comprises:

(a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, thereby allowing an individual to act with integrity, and exercise objectivity and professional scepticism.

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's, or an audit or assurance team member's, integrity, objectivity or professional scepticism has been compromised.

As set out in paragraphs 400.5 and 900.4, references to an individual or firm being "independent" mean that the individual or firm has complied with Parts 4A and 4B, as applicable.

Indirect financial interest

A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control or ability to influence investment decisions.

Inducement

An object, situation, or action that is used as a means to influence another individual's behaviour, but not necessarily with the intent to improperly influence that individual's behaviour.

Inducements can range from minor acts of hospitality between assurance practitioners and existing or prospective clients to acts that result in non-compliance with laws and regulations. An inducement can take many different forms, for example:

- *Gifts.*
- *Hospitality.*
- *Entertainment.*
- *Political or charitable donations.*
- *Appeals to friendship and loyalty.*
- *Employment or other commercial opportunities.*
- *Preferential treatment, rights or privileges.*

Key audit partner

The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgements on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, "other audit partners" might include, for example, audit partners responsible for significant subsidiaries or divisions.

[NZ] Key assurance partner

The engagement partner, the individual responsible for the engagement quality control review, and other assurance partners, if any, on the engagement team who make key decisions or judgements on significant matters with respect to the assurance engagement.

Listed entity

[*Deleted by the NZAuASB]*

May

This term is used in the Code to denote permission to take a particular action in certain circumstances, including as an exception to a requirement. It is not used to denote possibility.

Might

This term is used in the Code to denote the possibility of a matter arising, an event occurring or a course of action being taken. The term does not

	ascribe any particular level of possibility or likelihood when used in conjunction with a threat, as the evaluation of the level of a threat depends on the facts and circumstances of any particular matter, event or course of action.
Network	A larger structure: (a) That is aimed at co-operation; and (b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.
Network firm	A firm or entity that belongs to a network. *For further information, see paragraphs 400.50 A1 to 400.54 A1.*
Non-compliance with laws and regulations	*Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, which are contrary to the prevailing laws or regulations committed by the following parties:* *(a) A client;* *(b) Those charged with governance of a client;* *(c) Management of a client; or* *(d) Other individuals working for or under the direction of a client.* *This term is described in paragraph 360.5 A1.*
[NZ] Offer document	A document, such as a product disclosure statement or a disclosure document, required by legislation to be prepared by an entity when financial products are offered to the public.
Office	A distinct sub-group, whether organised on geographical or practice lines.
Predecessor accountant	A professional accountant in public practice who most recently held an audit appointment or carried out accounting, tax, consulting or similar professional services for a client, where there is no existing accountant.
Professional accountant	*[Deleted by the NZAuASB]*
Professional accountant in business	*[Deleted by the NZAuASB]*

Professional accountant in public practice	*[Deleted by the NZAuASB]*
Professional activity	An activity requiring accountancy or related skills undertaken by an assurance practitioner, including accounting, auditing, tax, management consulting, and financial management.
Professional services	Professional activities performed for clients.
[NZ] Proposed assurance practitioner	An assurance practitioner who is considering accepting an audit, review or assurance appointment for a prospective client (or in some cases, an existing client).
[NZ] Public interest entity	Any entity that meets the Tier 1 criteria in accordance with XRB A1[4] and is not eligible to report in accordance with the accounting requirements of another tier.
Reasonable and informed third party Reasonable and informed third party test	*The reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the conclusions are made. The reasonable and informed third party does not need to be an accountant, but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant's conclusions in an impartial manner.* *These terms are described in paragraph R120.5 A4.*
Related entity	An entity that has any of the following relationships with the client: (a) An entity that has direct or indirect control over the client if the client is material to such entity; (b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity; (c) An entity over which the client has direct or indirect control; (d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and

[4] XRB A1 *Application of the Accounting Standards Framework*

(e) An entity which is under common control with the client (a "sister entity") if the sister entity and the client are both material to the entity that controls both the client and sister entity.

Responsible party

In an assurance engagement, the party responsible for the underlying subject matter.

Review client

An entity in respect of which a firm conducts a review engagement.

Review engagement

An assurance engagement, conducted in accordance with *International Standards on Review Engagements (New Zealand) 2400* or New Zealand Standard on Review Engagements 2410, in which an assurance practitioner expresses a conclusion on whether, on the basis of the procedures which do not provide all the evidence that would be required in an audit, anything has come to the assurance practitioner's attention that causes the assurance practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.

Review team

(a) All members of the engagement team for the review engagement; and

(b) All others within a firm who can directly influence the outcome of the review engagement, including:

   (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the review engagement, including those at all successively senior levels above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent);

   (ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the engagement; and

   (iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and

(c) All those within a network firm who can directly influence the outcome of the review engagement.

Safeguards

Safeguards are actions, individually or in combination, that the professional accountant takes that effectively reduce threats to compliance with the fundamental principles to an acceptable level.

This term is described in paragraph 120.10 A2.

Substantial harm

This term is described in paragraph 360.5 A3.

Special purpose financial statements	Financial statements prepared in accordance with a financial reporting framework designed to meet the financial information needs of specified users.
Subject matter information	The outcome of the measurement or evaluation of the underlying subject matter against the criteria, i.e., the information that results from applying the criteria to the underlying subject matter.
Those charged with governance	The person(s) or organisation(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance might include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.
Threats	*This term is described in paragraph 120.6 A3 and includes the following categories:* *Self interest* 120.6 A3(a) *Self-review* 120.6 A3(b) *Advocacy* 120.6 A3(c) *Familiarity* 120.6 A3(d) *Intimidation* 120.6 A3(e)
Time-on period	*This term is described in paragraph R540.5.*
Underlying subject matter	The phenomenon that is measured or evaluated by applying criteria.

C: EFFECTIVE DATE

Part 4B relating to independence for assurance engagements with respect to underlying subject matter covering periods will be effective for periods beginning on or after 15 June 2021; otherwise, it will be effective on 15 June 2021. Early adoption will be permitted.

NZ AUDITING AND ASSURANCE STANDARDS BOARD

Agenda item 11.4

Memorandum

Date: 12 February 2020

To: Michele Embling, Chairman XRB Board

From: Robert Buchanan, Chairman NZAuASB

Subject: Certificate Signing Memo: Amendments to Professional and Ethical Standard 1: Part 4B – Independence for Assurance Engagements Other Than Audit and Review Engagements

Introduction

1. In accordance with the protocols established by the XRB Board, the NZAuASB seeks your approval to issue Amendments to Professional and Ethical Standard 1: Part 4B – Independence for Assurance Engagements Other Than Audit and Review Engagements.

Background

International process

2. Part 4B of the International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code) issued by the International Ethics Standards Board for Accountants (IESBA) comprises the independence standards for assurance engagements other than audit or review engagements.

3. In March 2019, the IESBA approved proposed revised Part 4B of the Code (the "Part 4B ED") for exposure. The objective of the revisions to Part 4B were to make the provisions in that Part consistent with the revised assurance terms and concepts in ISAE 3000 (Revised)[1].

4. The comment period for the Part 4B ED closed on 26 June 2019. Twenty-six comment letters were received from various respondents, including regulators, oversight bodies, national standard setters (including the NZAuASB), accounting firms, IFAC member bodies and other professional organisations.

5. The revisions to Part 4B of the IESBA Code were approved in September 2019 with the unanimous approval of IESBA members. The final standard was issued in January 2020.

[1] ISAE 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

Domestic process

6. The NZAuASB sought feedback from constituents on the IESBA proposals concurrently with the IESBA exposure. No submissions were received.

7. The Amendments to PES 1, based on the International Code, include amendments for New Zealand terminology and spelling changes.

Australian process

8. The Accounting Professional & Ethical Standards Board (APESB) is expected to consider the revisions to Part 4B of the IESBA Code at its June 2020 meeting.

Privacy

9. The Financial Reporting Act 2013, section 22(2) requires that the External Reporting Board consult with the Privacy Commissioner where an accounting or assurance standard is likely to require the disclosure of personal information. No such consultation is required in relation to this standard.

Due process

10. The due process followed by the NZAuASB complied with the due process requirements established by the XRB Board and in the NZAuASB's view meets the requirements of section 12(b) of the Financial Reporting Act 2013.

Consistency with XRB Financial Reporting Strategy

11. The adoption of the Amendments to Professional and Ethical Standard 1: Part 4B – Independence for Assurance Engagements Other Than Audit and Review Engagements is consistent with one of the key strategic objectives set by the XRB Board for the NZAuASB to adopt international ethical standards, as applying in New Zealand unless there are compelling reasons not to.

Other matters

12. There are no other matters relating to the issue of this standard that the NZAuASB considers to be pertinent or that should be drawn to your attention.

Recommendation

13. The NZAuASB recommends that you sign the attached certificate of determination on behalf of the XRB Board.

Attachments

Amendments to Professional and Ethical Standard 1: Part 4B – Independence for Assurance Engagements Other Than Audit and Review Engagements

Robert Buchanan

Chair NZAuASB

Agenda Item 12.1

NZ AUDITING AND ASSURANCE STANDARDS BOARD

DATE: 31 January 2020

TO: Members of the New Zealand Auditing and Assurance Standards Board

FROM: Peyman Momenan

SUBJECT: **International Update**

Introduction

1. This Update summarises the significant news of the IAASB, other national auditing standards-setting bodies and professional organisations for the Board's information, December 2019 and January 2020.

International Federation of Accountants (IFAC)

1. IFAC today released the second installment of its *Exploring the IESBA Code* educational series: *The Conceptual Framework – Step 1, Identifying Threats*.

   Exploring the IESBA Code is a twelve-month series providing an in-depth look at the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code). Each installment focuses on a specific aspect of the Code using real-world situations in a manner that is relatable and practical. Readers will gain a better understanding of the thought process behind more complicated areas of the Code through storytelling and expert analysis from professionals involved in developing the standards.

   The first installment of the Series looked at the five Fundamental Principles of ethics, which establish the standard of behaviour expected of all professional accountants. Compliance with these principles enable accountants to meet their responsibility to act in the public interest. This second installment highlights key aspects of the Code's Conceptual Framework, which is an approach that all professional accountants are required to apply to comply with the five principles. The installment focuses on identifying threats and will be supplemented by two subsequent installments that will deal with evaluating and addressing threats.

2. On 17th of January 2020, leading accounting bodies and other organisations have called for corporate and asset owner action and improved reporting on the UN's Sustainable Development Goals (SDG) in an attempt to hit goals set for 2030. The recommendations are detailed in the report, *Sustainable Development Goals Disclosure (SDGD) Recommendations*, authored by Carol Adams, Professor of Accounting, with Paul Druckman and Russell Picot, Honorary Professors at Durham University Business School.

   The report has been published by global accountancy bodies - International Federation of Accountants (IFAC), Association of Chartered Certified Accountants (ACCA), Institute of Chartered Accountants of Scotland (ICAS), Chartered Accountants Australia and New Zealand (CA ANZ), the International Integrated Reporting Council (IIRC) and the World Benchmarking Alliance. It is also endorsed by the Director of SDG Impact from the United Nations Development Programme (UN-DP).

The SDGD Recommendations offer a new approach for businesses and other organisations to address sustainable development issues aligned to the three most influential and popular reporting frameworks. They attempt to establish a best practice for corporate reporting on the SDGs and enable more effective and standardized reporting and transparency on climate change, social and other environmental impacts.

The *SDGD Recommendations* were developed through consultation with accounting and finance professionals, sustainability experts, academics, consultants, framework and standard setters, asset owners and managers and civil society participants.

International Auditing and Assurance Standards Board (IAASB)

1. The IAASB Ongoing projects (refer to appendix 1)

2. The International Auditing and Assurance Standards Board (IAASB) released a *Feedback Statement sharing* what the Board has heard regarding audits of less complex entities in response of its recent Discussion Paper: *Audits of Less Complex Entities (LCEs): Exploring Possible Options to Address the Challenges in Applying the ISAs.*

International Ethics Standards Board for Accountants (IESBA)

1. The International Ethics Standards Board for Accountants® (IESBA®) released two Exposure Drafts (EDs) in January 2020:
   - *Proposed Revisions to the Non-Assurance Services Provisions of the Code*
   - *Proposed Revisions to the Fee-Related Provisions of the Code*

   The EDs are aimed at strengthening the non-assurance services (NAS) and the fee-related independence provisions of the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code). The EDs represent a key milestone in two major strategic commitments of the IESBA in its current strategy and workplan.

   Among the key changes proposed to the NAS provisions are:
   - A prohibition on providing NAS to an audit client that is a public interest entity (PIE) if a self-review threat to independence will be created;
   - Further tightening of the circumstances in which materiality may be considered in determining the permissibility of a NAS;
   - Strengthened provisions regarding auditor communication with those charged with governance (TCWG), including, for PIEs, a requirement for NAS pre-approval by TCWG; and
   - Stricter requirements regarding the provision of some NAS, including certain tax and corporate finance advice.

   The NAS ED also includes enhanced guidance to assist firms in evaluating the level of threats to independence when providing NAS to audit clients.

   Among the key proposed changes to the fee-related provisions are:
   - A prohibition on firms allowing the audit fee to be influenced by the provision of services other than audit to the audit client;
   - In the case of PIEs, a requirement to cease to act as auditor if fee dependency on the audit client continues beyond a specified period; and
   - Communication of fee-related information to TCWG and to the public to assist their judgments about auditor independence.

   The Fees ED also includes enhanced guidance on identifying, evaluating and addressing threats to independence in relation to other fee-related matters, including the proportion of fees for services other than audit to the audit fee.

Accountancy Europe (AE) (former FEE)

1. The *European Single Electronic Format (ESEF)* will become effective as from 2020. This is a significant step forward for the accessibility and comparability of the financial information of the issuers on EU regulated markets. It is now up to each EU Member State to develop the implementation of ESEF and to maximise the benefits digitalisation can offer.

   This document has been prepared by Accountancy Europe together with the European Contact Group (ECG) as a contribution to ESEF implementation efforts. Investor protection and the public interest have been the overarching principles applied while drafting this document. It sets outs specific considerations along with practical implications which may assist auditors in their role to provide an assurance conclusion in connection with ESEF.

Public Interest Oversight Board of IFAC (IPIOB)

2. There have been no significant developments related to audit and assurance to report in the period.

International Integrated Reporting Council (IIRC)

1. There have been no significant developments related to audit and assurance to report in the period.

Global Reporting Initiative (GRI)

1. The World Economic Forum have today published Toward Common Metrics and Consistent Reporting of Sustainable Value Creation, which looks at ESG disclosure frameworks and references GRI widely throughout.

International Forum of Independent Audit Regulators (IFIAR)

1. The IFIAR 2019 survey data indicates that the largest global audit firm networks (GPPC networks) collectively achieved a 21% reduction over four years in the frequency of audits inspected with findings, resulting in 31% of inspected audits with findings. While IFIAR is encouraged by this decrease, it is disappointed that the reduction target was not met and that the overall frequency of inspection findings remains too high.   More information about the survey, including reports summarizing the annual survey results, is found on IFIAR's website.

International Organization of Supreme Audit Institutions (INTOSAI)

1. There have been no significant developments related to audit and assurance to report in the period.

International Organization of Securities Commissions (IOSCO)

1. There have been no significant developments related to audit and assurance to report in the period.

Australia

The Australian Auditing and Assurance Standards Board (AUASB)

1. The AUASB Chair presented to the Parliamentary Inquiry into the Regulation of Auditing in Australia on 29th November 2019. Board members reviewed various elements of the submissions and presentations made to the inquiry by the AUASB and other parties.
2. The AUASB considered and provided input into the updated draft of GS 005 Using the Work of a Management’s Expert. The AUASB requested several amendments to the draft guidance statement, which will be shared with the GS 005 Project Advisory Group and then brought back to the March 2020 AUASB meeting for consideration and approval.

3. The AUASB received an update on the work the joint AUASB/NZAuASB subcommittee have done on this standard since the last AUASB meeting in September 2019, as well as details of the
4. NZAuASB's deliberations on the feedback received from their stakeholders on the proposed changes to the equivalent NZAuASB exposure draft. The AUASB continues to consider how to best describe the auditor's responsibility relating to going concern in the auditor's review report and discussed feedback from stakeholders on other questions asked in the Exposure Draft. The AUASB requested that the sub-committee consisting of Members and technical staff from the AUASB and NZAuASB continue to work together to workshop possible solutions.
5. The AUASB were provided with an update of the AUASB Technical Group's work to update GS 008, including addressing the two key issues raised by AUASB members since this Guidance Statement was presented to the AUASB in September 2019. The AUASB determined that the wording related to materiality in GS 008 needed to be revised and better linked to ASA 320 Materiality in Planning and Performing an Audit and ASAE 3000 Assurance Engagements Other than Audits or Reviews of Historical Financial Information. The AUASB Technical Group were also directed to undertake further outreach with stakeholders about the options for the wording of Auditor's Report on the Remuneration Report and present revised wording for consideration at the February 2020 meeting.

United Kingdom

FRC

1. On 29 January 2018 the FRC announced the opening of an **investigation** in relation to KPMG's audit of the financial statements of Carillion plc, for the years ended 31 December 2014, 2015 and 2016, and additional audit work carried out during 2017. We provided updates on the progress of the investigation in May 2018 and January 2019. In February 2019 we announced the opening of an investigation in respect of the audit of certain matters relating to the financial statements of Carillion plc for the year ended 31 December 2013.

   Our investigation of the audits is well advanced. An extensive review has been undertaken of a substantial volume of material, including the audit work papers, documents produced by Carillion and third parties e.g. internal auditors and external advisors, and emails and other correspondence. We have also conducted a series of detailed interviews. An independent expert is now considering our analysis in order to provide an expert opinion on whether there were breaches of auditing standards. We are also taking advice from external Counsel and we continue to cooperate to the fullest extent permissible with other regulators pursuing parallel investigations.

   The scale and complexity of this case is exceptional, with a huge volume of documents and information that has had to be reviewed and analysed. The investigation encompasses a four-year period, and numerous significant audit areas, including the accounting for construction and services contracts, pensions liabilities, goodwill and going concern. All of the accounting years and each of the audit areas identified remain under active consideration The FRC therefore currently expects to complete the first stage of its investigation by summer 2020, rather than by January 2020.

   We are also investigating the conduct of Mr Richard Adam and Mr Zafar Khan, former group finance directors of Carillion and members of the ICAEW, in connection with the preparation of Carillion's financial statements during the same period, as well as an additional, investigation into KPMG in connection with the FRC's Audit Quality Review into aspects of the audit of Carillion for the year end 2016. These investigations have inevitably impacted on the the audit investigations and their progress.

2. The FRC issued an update of its Practice Aid to assist audit committees in evaluating audit quality in their assessment of the effectiveness of the external audit process.

   The update takes account of developments since the first edition was issued in 2015, including revisions of the UK Corporate Governance Code, the requirement for all Public Interest Entities (PIEs) to conduct a tender at least every 10 years and rotate auditors after at least 20 years, and increasing focus generally on audit quality and the role of the audit committee. It also takes account of commentary from audit committees suggesting how the Practice Aid could be more practical in focus and more clearly presented.

Institute of Chartered Accountants in England and Wales

1. In January 2020, ICAEW published guidance on conducting assurance engagements on the internal controls of service organisations, following a public consultation last year.

   Assurance reports on internal controls of service organisations made available to third parties (TECH 01/20 AAF) replaces TECH 01/06 AAF and will come into effect for reporting periods beginning on or after 1 July 2020.

   Organisations often outsource aspects of their business activities to third party 'service organisations'. The guidance enables service organisations to engage an independent practitioner to provide an assurance opinion on the controls in place over those outsourced activities. The opinion can then be made available to user organisations and their external auditors, avoiding the need for several different user organisations to test the same controls.

The Charity Commission

1. The Charity Commission can now refer cases of poor professional practice by accountants and finance professionals to ACCA, (the Association of Chartered Certified Accountants). The two bodies have signed an agreement on the sharing of data, which facilitates the referral of concerns about accountancy services provided to charities.

   It comes as part of the regulator's wider work with the accountancy and audit profession aimed at raising the standard of financial reporting by charities and encouraging the highest professional standards amongst practitioners working with the charity sector. The move follows the launch of the external scrutiny benchmark in August 2019.

   The new undertaking establishes a process for sharing information that is lawful, safe and secure, and more generally provides a framework for closer working between the two bodies, both at strategic and operational levels.

   The undertaking allows, in certain circumstances, for the Commission to share details about individual ACCA members with their professional body; ACCA can ultimately institute disciplinary proceedings against a member. The document also provides for ACCA to share information with the regulator.

   The Commission's ultimate purpose in signing up to the agreement is to provide a mechanism to alert ACCA to poor practice and, by raising the standards of ACCA practitioners undertaking external scrutiny work for charities, help charities comply with their accounting framework and legal requirements.

Association of Chartered Certified Accountants (ACCA)

1. There have been no significant developments related to audit and assurance to report in the period.

United States of America

Public Company Accounting Oversight Board (PCAOB)

1. As part of the Public Company Accounting Oversight Board's (PCAOB) strategic goal of enhancing transparency and accessibility, we are committed to engaging more directly and more often with public company audit committees.

In 2019, we had conversations with the audit committee chairs of almost all of the U.S. issuers whose audits we inspected and offered them the opportunity to speak with our inspections teams. Once our 2019 inspections are complete, we expect to have spoken with nearly 400 audit committee chairs. By contrast, historically, we have reached out to a small percentage of audit committee chairs during our inspections process. In 2018, for example, we spoke with 88 audit committee chairs. We view an engaged and informed audit committee as an effective force multiplier in promoting audit quality and were grateful for the opportunity to speak with so many audit committee chairs. Continuous dialogue with audit committees on areas of mutual importance helps us to advance our mission and may assist audit committees in fulfilling their duties.

To that end, our conversations focused broadly on audit quality, with specific discussions around such topics as audit committee perspectives of the auditor, new auditing and accounting standards, and technology and innovation. Audit committee chairs provided informative and valuable feedback on these topics and were appreciative of the opportunity to engage directly with the PCAOB. They expressed particular interest in learning more about the PCAOB's inspections process.
Audit committee chairs also often asked for additional tools, resources, and learning opportunities from the PCAOB, and many were interested in learning about what we heard from their peers during these calls.

To that end, in this document we share:

- What we frequently heard from audit committee chairs and perspectives from them on what is working well to help improve audit quality;
- An overview of our inspections process; and
- Staff responses to frequently asked questions (FAQs) during the conversations.

American Institute of Certified Public Accountants (AICPA)

1. There have been no significant developments related to audit and assurance to report in the period.

Center for Audit Quality (CAQ) - (affiliated with AICPA)

1. There have been no significant developments related to audit and assurance to report in the period.

Other news from US:

1. How firms are delivering value with audit data analytics? When Ed Wilkins, CPA, talks to audit committees about adding data analytics to the audit process, he explains to them that it usually takes three years for investment in a complex audit analytic to pay for itself. (continue reading here)

2. Accounting firms are beginning to wade into the use of blockchain technology for audits, but with caution as the technology spreads beyond the cryptocurrency space where it's been used for digital assets like Bitcoin.

   "I don't know that blockchain is going to necessarily make things easier for auditors," said Amy Steele, an audit and assurance partner at Deloitte & Touche LLP and co-chair of the AICPA Digital Assets Working Group, and a member of the Center for Audit Quality Emerging Technologies Task Force. "I do think it's going to impact the audit profession and change things. With the use cases within an audit firm, a number of firms are looking at how blockchain can be used within the firm to synthesize the data that we have. I would say that's still more within the ideation phase rather than the implementation phase." (continue reading here)

Canada

Canadian Auditing and Assurance Standards Board (AASB)

2. There have been no significant developments related to audit and assurance to report in the period.

CPA Canada

1. There have been no significant developments related to audit and assurance to report in the period.

Project	Overview of the project and its current status
Quality Control Has update for the period	**Objective of the Project:** Initial activities in scoping the project will focus on whether there is a need to revisit specific aspects of the quality control standards to enhance clarity and consistency of their application. This may include restructuring ISQC 1, additional requirements or guidance within the standard or additional guidance in support of the standard. Specific aspects within ISQC 1 and ISA 220 being explored include, governance, engagement partner responsibilities, engagement quality control reviews, monitoring, remediation, alternative audit delivery models and specific issues pertaining to small- and medium-sized practices **Background and current status:** The proposed changes to QC where included in the IAASB Audit Quality ITC. The ITC response period is closed now. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, and developed project proposals for quality control that were presented at the September 2016 IAASB meeting. The IAASB considered the Quality Control Other Working Group's (QCOWG) proposals in respect of: • Setting the objective of an engagement quality control (EQC Revising the definition of an EQC review; • Determining the scope of the engagements subject to an EQC review; and • The execution of an EQC review. At its March 2017 meeting, the IAASB discussed matters to do with the eligibility of the engagement quality control reviewer. **QC-Firm Level** In June 2017 the Board discussed the Quality Control Task Force's (QCTF) recommendations on the possible revisions to ISQC 1, a result of incorporating a quality management approach (QMA) into ISQC 1, that included a discussion of a working draft of ISQC 1 (Revised) and how the proposals are expected to change firm behaviors. The Board was supportive of the overall direction proposed by the QCTF and emphasized the importance of outreach with a variety of stakeholders to seek input on the practicality of the proposals. The Board also encouraged the QCTF to develop guidance and examples to accompany the revised standard in order to explain the implementation and application of the standard. In its September 2017, the Board discussed the Quality Control Task Force's (QCTF) recommendations on the possible revisions to ISQC1 in relation to documentation of the system of quality management. The Board was supportive of the QCTF's proposals and suggested various refinements. Some of the key proposals were as follow: • the proposal to retain the requirement for an EQC review for all audits of financial statements of listed entities, i.e., not only for general purpose financial statements

	• the proposals in relation to other engagements for which the firm determines that an EQC review is required (see here for details) • the objective of ISQC 2, including whether it is appropriate to locate the responsibilities of the EQC reviewer in ISQC 2, instead of ISA 220 • the IAASB supports the proposal to remove the reference to “team” from the definition of an EQC reviewer, and instead explain the use of a team in the application material supporting the appointment of the EQC reviewer • the proposed requirements and application material in relation to the eligibility of the EQC reviewer. The Board also discussed the QCTF’s recommendations in relation to EQC reviews that would be incorporated in ISQC 1 and the proposed new standard, ISQC2. The Board confirmed that the purpose of the EQC review is to evaluate the significant judgments made by the engagement team. In addition to various recommendations to further enhance and clarify the various requirements and application material, the Board encouraged the QCTF to improve the robustness of the requirement relating to the scope of the engagements subject to EQC review. In December 2017, the Board discussed a first read of the proposed exposure draft of ISQC 1 (Revised) 5 and was broadly supportive of the direction of the standard. The Board focused on the scalability of the standard, clarifying the interrelationship of the components, and the appropriate placement of the governance and leadership component. As well as requesting the Task Force to clarify the meaning of deficiencies and major deficiencies, the Board asked that a framework be developed for assessing deficiencies in the system of quality management and requested clarification of how such deficiencies may impact the achievement of the overall objective of the standard. The Board also asked the Task Force to reconsider the threshold for the identification of quality risks and encouraged the Task Force to explore the development of appropriate guidance to accompany the proposed exposure draft that addresses the application of the standard to a spectrum of firms. The Board discussed the exposure draft (ED) of proposed ISQC 1 (Revised)1 and was supportive of the direction that the Quality Control Task Force was taking the standard, noting the improvement in the readability and understandability overall. The Board encouraged the Quality Control Task Force to consider whether there are further opportunities to address scalability, including further refinement and simplification of the standard, where possible. The Board also discussed changing the title of the standard In finalizing the ED in December 2018, the Board discussed the definition of deficiencies and bringing more emphasis to positive findings from the firm’s monitoring activities and how they may be used in the system of quality management. The Board also discussed the requirement for the firm to establish additional quality objectives beyond those required by the standard and further clarifying the identification and assessment of quality risks. In addition, the Board suggested further simplification of the requirement addressing communication with external parties, although in general agreed to retain an explicit reference to transparency reports in the requirement. The Board also discussed network requirements or network services, and

adjusted the requirement to clearly reflect the expectations of the firm regarding the effect of network requirements or network services on the firm's system of quality management.

The Board supported the Quality Control Task Force's recommendations regarding matters to be addressed in the Explanatory Memorandum, including the proposed questions.
In September 2019, the Board discussed the comment letters received on certain areas of the Exposure Draft (ED) of ISQM 1 (ED-ISQM 1)[3] relating to the quality management approach, implementation challenges, the components and structure of the standard and the firm's risk assessment process. The Board concurred that four significant themes had emerged from the comments: scalability; prescriptiveness; addressing firms who do not perform audit or assurance engagements; and challenges with implementation. The Board, in general, supported proposals to address the structure of the standard and clarify the nature of the components and how they interrelate. The Board also supported addressing the granularity of the quality objectives, introducing quality risk considerations, and refining the required responses. The Board agreed with the ISQM 1 Task Force's proposals to simplify the firm's risk assessment process, including addressing concerns about the threshold for the identification of quality risks. The Board did not support the proposal to develop a separate standard for quality management for related services engagements and encouraged exploration of other ways to address scalability concerns. The ISQM 1 Task Force will take these comments into account in preparing revised drafting and issues for discussion at the December 2019 IAASB meeting.

Update for the period:

In December 2019, the Board continued to discuss the key issues highlighted by respondents to the Exposure Draft (ED) of ISQM 1[3] (ED-ISQM 1) including the scalability, complexity and prescriptiveness of the standard. appropriate tailoring of the system of quality management for their circumstances and the making sure the standard that can be applied in all circumstances.

The Board supported the changes to the structure of the standard, adjusting the quality objectives and responses in the components to be more streamlined and the revisions to the drafting and presentation of the standard to simplify and improve the readability of the standard. The Board also agreed with proposed revisions to the firm's risk assessment process, including introducing factors to consider in identifying and assessing quality risks.

The Board supported the ISQM 1 Task Force's proposals to embed a risk-based approach in the monitoring and remediation component, improve the selection of engagements for inspection such that it is more risk-based, and further clarify the framework for evaluating findings and identifying deficiencies.

Quality Control – Engagement Level

In December 2017, The IAASB supported the direction of the proposed changes to ISA 220.[4] In particular, the Board supported the proposed changes

	that emphasize that the engagement partner is responsible and accountable for audit quality. The Board encouraged the ISA 220 Task Force to consider, as it progresses revisions to ISA 220, how the proposed changes will strengthen the performance of quality audits. The Board discussed a draft ED of proposed ISA 220 (Revised)[2] and was supportive of the proposed changes. The discussions focused on whether changes were needed to the objective of the standard and the wording of the requirement regarding the engagement partner being “sufficiently and appropriately involved.” The Task Force plans on presenting the ED of proposed ISA 220 (Revised) for approval by the Board at the December 2018 meeting. In December 2018 the Board supported the requirement for the firm to establish policies or procedures addressing limitations on the engagement partner moving into the role of engagement quality reviewer, including the reference to a cooling-off period in the application material. The Board agreed that stakeholder views were needed relating to the objectivity of the engagement quality reviewer and a cooling-off period and supported the ISQM 2 Task Force’s recommendation for including specific questions in the Explanatory Memorandum on this matter to be developed in coordination with the IESBA. The Board also clarified the requirement for notifications by the engagement quality reviewer to the engagement partner and, when applicable, individual(s) within the firm, as well as the documentation requirements. The Board discussed the requirements that address firm policies or procedures, the role of the engagement partner vis-à-vis other members of the engagement team and the difference between the usages of the phrases “the auditor shall determine” and “the auditor shall be satisfied.” The board also discussed how best to clarify the requirement addressing communications from the firm about the firm’s monitoring and remediation process. In September 2019, the Board discussed the comment letters received to ED-ISA 220[5] and the ISA 220 Task Force’s proposals for addressing the key issues respondents raised. The Board supported the fundamental principle that the engagement partner has overall responsibility for managing and achieving quality and being sufficiently and appropriately involved in the engagement. The Board also supported clarifying the requirement addressing circumstances when the engagement partner assigns procedures or tasks to other engagement team members, the principles underpinning the proposed engagement team definition and proposals to address scalability of the requirements to audits of larger or more complex entities. The ISA 220 Task Force will take these comments into account in preparing revised drafting and issues for discussion at the December 2019 IAASB meeting. Update for the period The Board generally supported the ISA 220[5] Task Force’s proposals to clarify the engagement team definition, to make clear that the engagement team can ordinarily depend on the firm’s system of quality management, and to better deal with large, complex audit engagements. The Board also discussed professional skepticism, the stand-back provision and the

	documentation requirements. The ISA 220 Task Force will consider the comments received in preparing a revised full draft of proposed ISA 2202 for discussion at the March 2020 IAASB meeting.
Group Audits–ISA 600 **No Update for the period**	**Objective of the project:** Determining the nature of the IAASB's response to issues that have been identified, relating to Group Audits, from the ISA Implementation Monitoring project and outreach activities, inspection reports from audit regulators, discussion with NSS and responses to the IAASB's Work Plan consultation (i.e., whether standard-setting activities are appropriate to address the issues, and if so, whether specific enhancements within ISA 600 or a more holistic approach to the standard would be more appropriate). **Background and current status:** The IAASB commenced work on one aspect of this project relating to the responsibilities of the engagement partner in circumstances where the engagement partner is not located where the majority of the audit work is performed in December 2014. A Staff Audit Practice Alert on this aspect was published in August 2015. Information gathering on the broader aspects of group audits commenced in March 2015. The issues identified and discussed at the IAASB meetings form part of a combined Invitation to Comment on Enhancing Audit Quality in the public interest which was issued in December 2015 and is open for comments till May 16, 2016. The ITC is now closed. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, presented the results to IAASB at the September 2016 IAASB meeting. In its June 2017 meeting, the IAASB received an update on the activities of the GATF. The IAASB supported the proposal of the GATF to engage more directly with the QCTF, ISA 220 TF and ISA 315 (Revised)3 TF, to help ensure that the requirements in those standards provide appropriate connection points between those projects and ISA 600.4 The IAASB also supported the proposal of the GATF to publish a short project update and asked the GATF to consider topics that are related to standards not under revision, for example, materiality and audit evidence. In December 2017, the Board received a presentation about the interconnections between ISA 600 and other ongoing projects, and how the Task Force is monitoring the activities of the other task forces, providing input and considering implications of changes in the other standards on ISA 600. In March 2019, the Board was updated on the work performed by the Group Audit Task Force since the start of the project to revise ISA 600[1] and was asked for its views on issues related to scoping a group audit, the definitions, and the linkages with other ISAs. The Board continued to support developing a risk-based approach for scoping a group audit and generally supported the Group Audit Task Force's approach on the definitions and the issues that were presented in relation to the responsibilities of the group engagement partner, acceptance and continuance, understanding the group and its components, understanding the component auditor, identifying and assessing the risks of

[1] International Standard on Auditing (ISA) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

material misstatement and responding to assessed risks, the consolidation process, communication between the group auditor and component auditors, and evaluating the audit evidence obtained. These and other issues need to be further developed in the context of the risk-based approach and changes made to other of the IAASB's International Standards. The Group Audit Task Force will continue to work on the issues related to scoping a group audit, the definitions and other issues identified in the Invitation to Comment, and will present it for further discussion at the June 2019 IAASB meeting.

In June 2019, the Board was updated on the ISA 600[3] Task Force's progress since the March 2019 meeting and discussed the public interest issues that the ISA 600 Task Force identified, the ISA 600 Task Force's proposals with respect to the risk-based approach to scoping a group audit, and the special considerations related to auditing a group. The Board also discussed indicative drafting related to the risk-based approach to scoping a group audit and the special considerations related to proposed ISA 220 (Revised).[4] Generally, the Board was supportive of the approach taken but had suggestions on the way forward and the indicative drafting. The ISA 600 Task Force will take these comments into account and will present further drafting at the September 2019 meeting. The ISA 600 Task Force will also continue its outreach to key stakeholders and coordinate with IESBA and other IAASB Task Forces as needed.

In September 2019, the Board was updated on the work of the ISA 600 Task Force since the June 2019 meeting, including the outreach performed and the feedback received from the IAASB's Consultative Advisory Group. The Board discussed, among other matters, the updated public interest issues, a draft of a significant part of the standard and the ISA 600 Task Force's proposals with respect to the scope and structure of the standard, materiality considerations in a group audit and a proposed stand-back requirement. The ISA 600 Task Force will take these comments into account in preparing revised drafting and issues for discussion at the December 2019 IAASB meeting.

Update for the period

In December 2019, the Board was updated on the work of the ISA 600 Task Force since the September 2019 meeting, including the outreach performed, and discussed a full draft of the proposed revised standard (except the appendices). The draft of proposed ISA 600 (Revised)[1] included updated requirements and application material on sections that were presented to the Board in September 2019 and new requirements and application material on, among other matters, materiality, communications with component auditors and documentation.

The ISA 600 Task Force will take the Board's comments on the proposed revised standard into account and will present an updated version for approval for public exposure at its March 2020 meeting. The Task Force will discuss the conforming amendments and the appendices to proposed ISA 600 (Revised) in the January 23, 2020 Board teleconference.

Professional Scepticism No Update for the period	**Objective of the project:** To make recommendations on how to more effectively respond to issues related to professional scepticism. **Background and current status:** The IAASB commenced its initial information gathering on the topic of professional scepticism in June 2015. The issues identified and discussed at the IAASB meetings are part of the Invitation to Comment on Enhancing Audit Quality in the Public Interest which was issued in December 2015 and is open for comments till May 16, 2016. The working group is comprised of representatives from the IAASB, the International Ethics Standards Board for Accountants (IESBA), and the International Accounting Education Standards Board (IAESB) to explore the topic of professional scepticism, enabling the three independent standard-setting Boards to consider what actions may be appropriate within their collective Standards and other potential outputs to enhance professional scepticism. Together with the Quality Control and ISA 600-Group Audits project, this project is part of the Audit Quality Enhancements Coordination Group (AQECG). The AQECG intends to coordinate the various inputs to the invitation to comment developed at the individual working group level, and take a holistic approach as to how the matters are presented in one invitation to comment. From May to September 2016, the various Working Groups analysed the comment letters to the Overview and detailed ITC, reviewed feedback from outreach activities, presented the results to IAASB at the September 2016 IAASB meeting. Subsequent to the December 2016 IAASB meeting, the joint PSWG held a teleconference to discuss matters related to potential changes to the concept/definition of professional scepticism in the ISAs. The March meeting papers are available here. In June 2017 meeting, the IAASB received an update on the activities of the Professional Skepticism Working Group (PSWG) and the Professional Skepticism IAASB Subgroup since the last Board meeting in March 2017. The Board supported the release of a communication to update stakeholders about the actions and current status of the PSWG's work. The Board also discussed the concept of "levels" of professional skepticism and supported the recommendations of the Professional Skepticism IAASB Subgroup not to introduce the concept into the ISAs. The IAASB discussed the Professional Skepticism Subgroup's analysis and related conclusions regarding different "mindset" concepts of professional skepticism and the use of the words in the ISAs in its December 2017. The Board supported the conclusions of the Subgroup, including that the current concept of the attitude of professional skepticism involving a "questioning mind" continues to be appropriate and should be retained within the ISAs. The IAASB Professional Skepticism Subgroup will liaise as needed with the Professional Skepticism Joint Working Group. In September 2018 meeting, The Board received an update on the activities of the IAASB's Professional Skepticism Subgroup (Subgroup) since March 2018. The Chair of the Subgroup also presented the Board with a draft

	publication that seeks to highlight the IAASB's efforts to appropriately reflect professional scepticism into the IAASB standards as well as other relevant news and information on professional skepticism, including collaboration with the International Ethics Standards Board for Accountants (IESBA) and International Accounting Education Standards Board (IAESB). The Board supported the issuance of the publication and future publications of this nature.
Data Analytics **No Update for the period**	**Objective of the project:** The objective of the Data Analytics Working Group (WG) is to: A) Explore emerging developments in audit data analytics; and B) Explore how the IAASB most effectively can respond via International Standards or non-authoritative guidance (including Staff publications) and in what timeframe. **Background and current status:** Information gathering on data analytics began in April 2015 and the Data Analytics Working Group will continue with its planned outreach activities in future. The DWAG published its first publication "The IAASB's Work to Explore the Growing Use of Technology in the Audit" in June 2016. At the March meeting, the IAASB received a video presentation of a panel discussion among members of the DAWG that was presented at the International Forum of Independent Audit Regulators Inspections Workshop. The Chair of the DAWG provides an update on the project in February 2017 on the IFAC website. In its June 2017 meeting, the IAASB received a presentation of high-level observations from respondents to the IAASB's Request for Input: Exploring the Growing Use of Technology in the Audit, with a Focus on Data Analytics. It was noted that respondents supported the IAASB in undertaking this work and encouraged continued active participation of the Data Analytics Working Group in other current standard-setting projects of the IAASB underway.
Emerging External Reporting **Has Update for the period**	**Objective of the project:** The objective of the Integrated Reporting Working Group (IRWG) is to: A) Explore emerging developments in integrated reporting and other emerging developments in external reporting; B) Gather further information on the demand for assurance, the scope of the assurance engagement and the key assurance issues; and C) Explore how the IAASB most effectively can respond via International Standards or non-authoritative guidance (including Staff publications) and in what timeframe. **Background and current status:** At its September 2014 meeting the Innovation WG proposed, and the IAASB agreed to establish a WG to specifically monitor the developing interest in integrated reporting and the demand for assurance on integrated reports. This includes initial thinking on the nature of such engagements, including the scope of the assurance engagement, the suitability of the criteria, and other matters related to assurance on integrated reports. The Board considered the draft working paper

	prepared by the IRWG *Supporting Credibility and Trust in Emerging Forms of External Reporting* in its June 2016. The Discussion Paper was issued in August 2016. In its June 2017 meeting, the IAASB received a presentation about the high-level observations from the comment letters received to the Discussion Paper, Supporting Credibility and Trust in Emerging Forms of External Reporting. It was noted that respondents generally supported the development of guidance on how to apply existing international assurance standards rather than developing new standards, and that the IAASB should continue to provide thought leadership on assurance issues and coordinate its work with other relevant organizations. The Board received an update on the project in December 2017. It was noted that the grant agreement with the World Business Council for Sustainable Development (WBCSD) was finalized for the funding of the project and that the Project Proposal and Feedback Statement has been finalized to be published on the IAASB's website. The board also received an update on the plan for developing the framework for the non-authoritative guidance for EER during the next year, including the required research to be gathered and the establishment of a Project Advisory Panel (PAP). In its September 2018 meeting, the EER Task Force presented the remaining Phase 1 'issues' that were not presented in June alongside a first draft of the Phase 1 guidance. The Board noted the need for the guidance to demonstrate its full alignment with the requirements of ISAE 3000 (Revised), 5 and for the EER Task Force to provide further explanations about any guidance that goes beyond the requirements and application material in ISAE 3000 (Revised). The EER Task Force expects to receive further input from stakeholders during its forthcoming series of discussion events and will present a revised draft of the guidance to the IAASB in December 2018. In December 2018 The EER Task Force presented an updated version of the Phase 1 draft guidance, which reflects changes to address feedback received from the IAASB at the September 2018 IAASB meeting, and from other stakeholders, including in relation to a 'materiality process' and assertions as they relate to the characteristics of suitable criteria. The Board noted that the draft guidance had significantly improved since discussions at the September 2018 meeting, but that further work on the drafting is enquired. The Board will discuss a further version on a teleconference in January 2019 before the draft guidance is published for public comment. In March 2019, the Board approved for public comment Phase 1 of the draft guidance in January 2019. At its March 2019 meeting, the Board discussed several challenges related to Phase 2 of the guidance. The challenges include: determining the scope of an EER assurance engagement; communicating effectively in the assurance report; exercising professional skepticism and professional judgment; obtaining the competence necessary to perform the engagement; and obtaining evidence in respect of narrative and future-oriented information. The Board's deliberations of the challenges concerned were facilitated through breakout sessions, after which each breakout group reported back to the Board in a plenary session. The EER Task Force will consider the

	inputs that were received in progressing the development of Phase 2 of the guidance for further discussion at the June 2019 IAASB meeting. In June 2019, the Board was updated on the work of the EER Task Force on the challenges allocated to Phase 2 of the project. These challenges include: determining the scope of an EER assurance engagement; obtaining evidence in respect of narrative and future-oriented information; exercising professional skepticism and professional judgment; obtaining the competence necessary to perform the engagement; and communicating effectively in the assurance report. The Board discussed views on the EER Task Force's initial proposals to address each of these challenges in the Phase 2 guidance. The EER Task Force will consider the inputs received from the Board, together with responses to the Phase 1 EER Consultation Paper in so far as they impact the Phase 2 guidance, in developing the draft Phase 2 guidance, which will be presented for discussion at the September 2019 IAASB meeting. In September 2019, the Board received an overview of the comment letters received on the EER Assurance Consultation Paper. The Board discussed respondents' comments on the Consultation Paper, that included the draft Phase 1 guidance, and the EER Task Force's proposals for addressing the comments. The Board also discussed the initial drafting of the Phase 2 guidance developed to date by the EER Task Force. A revised draft of the combined Phase 1 and Phase 2 guidance will be presented to the Board, for approval of an exposure draft at the December 2019 IAASB meeting. Update for the period In December 2019, the Board approved the combined restructured and redrafted non-authoritative EER Guidance, Special Considerations in Performing Assurance Engagements on Extended External Reporting, for public consultation. The consultation period will be 120 days from the date of publication. In finalizing the draft Guidance for public consultation, the Board agreed to emphasize that the guidance is non-authoritative and is not required to be read in its entirety, but is a useful reference source in applying particular requirements of the Standard. The Board also clarified the possible approaches to the use of framework criteria and entity-developed criteria and included additional guidance on fraud and on misstatements that might affect the practitioner's assessment of the control environment.
Agreed-Upon Procedures **Has update for the period**	**The objective of the project is to:** A) Revise International Standard on Related Services (ISRS) 4400, Engagements to Perform Agreed-Upon Procedures Regarding Financial Information in the Clarity format; and B) Consider whether standard-setting or other activities may be appropriate for engagements that use a combination of procedures derived from review, compilation and agreed-upon procedures engagements (also known as "hybrid engagements"), in light of the existing standards that may be applicable to these services in the IAASB's current suite of standards.

	Background and current status: During consultations on the IAASB's 2015-2019 Strategy and the related 2015-2016 Work Plan, many stakeholders expressed the need to revise ISRS 4400 to meet the growing demand for agreed-upon procedure engagements. In response to the stakeholders' comments, the IAASB established a working group to explore issues involving agreed-upon procedure engagements. The issues identified and discussed at the IAASB meetings will be used to revise ISRS 4400 and possibly develop new standard(s) or guidance that would address engagements where there is a combination of agreed-upon procedures and assurance. The Agreed-Upon Procedures (AUP) Working Group presented a first draft of its Discussion Paper, *Exploring the Growing Demand for Agreed-Upon Procedures Engagements and Other Services and the Implications for the IAASB's Standards*, to the Board in June 2016. The IAASB provided the AUP Working Group with input to enhance the Discussion Paper and suggested that the paper pose a question to explore whether the IAASB should develop guidance on multi-scope engagements. The AUP Working Group will present a revised draft of the Discussion Paper at the September 2016 IAASB meeting. In its September 2017 meeting, the Board discussed the feedback received on the Discussion Paper and **approved** a standard-setting project proposal to revise ISRS 4400, subject to clarifications around the use of judgment, independence, restriction of the report of factual findings and required documentation. In its September 2018 meeting, The Board approved the ED of ISRS 4400 (Revised)3 for public exposure. In finalizing the ED, the Board agreed that independence is not required for an AUP engagement and that the AUP report would include statements addressing circumstances when the practitioner is (or is not) required to be independent, and whether the practitioner is (or is not) independent. The ED will be issued in early November with a 120 day comment period. In June 2019 the Board received an overview of the responses to proposed ISRS 4400 (Revised)2 (ED–4400). The Board discussed, among other matters, respondents' comments on the application of professional judgment when performing procedures, the independence disclosure requirements, and the effective date. The Board also acknowledged areas of broad support, including not including a precondition for the practitioner to be independent, using the term "findings" and requiring an explanation of this term in the engagement letter and the AUP report, not requiring or prohibiting a reference to the practitioner's expert in the AUP report, and not requiring a restriction on use or distribution of the AUP report. The AUP Task Force will deliberate the Board's input and will present the first read of the post-exposure ISRS 4400 (Revised) to the Board in the second half of 2019. Update for the period The Board approved ISRS 4400 (Revised)2 with 17 Board members voting for approval and one vote against. The revised ISRS will be effective for agreed-upon procedures engagements for which the terms of engagement are agreed on or after January 1, 2022. Once the PIOB's confirmation that

	due process was followed is received, the Board will formally release the standard. In finalizing ISRS 4400 (Revised), the Board carefully deliberated the effective date and continued to focus on issues relating to compliance with independence requirements.
Less Complex Entities **Has update for the period**	In March 2019 the Board discussed a proposed Discussion Paper (DP), *Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Implementing the ISAs*. The discussion highlighted the shift in focus on complexity of the entity rather than its size in driving the ongoing discussions and activities to address issues and challenges in audits of less complex entities (LCEs). The Board was supportive of the DP's overall direction, noting the importance of the project and the need for action by the IAASB and others. The Board liked the simple, clear way the DP had been presented and noted it was appropriate for its key target audience (i.e., auditors of LCEs). The Board made suggestions for improvements, particularly with respect to the issues and challenges, the possible actions presented within the DP and the questions to be posed to respondents in order to obtain relevant and useful feedback. Proposed changes to the DP will be presented in a Board call on April 10th, with the final DP targeted to be published for public consultation before the end of April 2019. Update for the period The Board discussed the feedback received to date related to audits of less complex entities, including from the Discussion Paper (DP), Audits of Less Complex Entities (LCEs): Exploring Possible Options to Address the Challenges in Applying the ISAs, and other related outreach. The key messages received from the feedback highlighted the strong support for the IAASB's work in this area, as well as the need for a timely and global solution. The Board asked the LCE Working Group to continue to analyze the feedback from stakeholders to help determine the most appropriate way forward, and it was agreed that further information gathering activities would continue until June 2020, at which time it is anticipated that a decision about the way forward will be made. As part of the proposal for work in this area, the IAASB had agreed that it was important to keep stakeholders informed of its progress in relation to its work on audits of LCEs. Accordingly, the Board agreed to publish a Feedback Statement in December 2019 detailing what the IAASB had heard from its consultation and related outreach.
Audit Evidence has **No Update for the period**	The Board discussed the analysis undertaken by the Audit Evidence Working Group of the issues across the ISAs related to audit evidence and the use of technology more broadly, and the possible actions to address the issues. The Board concurred that guidance should be developed on the effect of technology when applying certain aspects of the ISAs, and that this should be actioned expeditiously. The Board also indicated that more extensive information gathering and research need to be undertaken to understand the issues related to audit

	evidence, so that the Board is fully informed of the issues in determining the need for revisions to ISA 5005 and possibly other related standards. In September 2019, the Board was provided with an overview of the development of the Audit Evidence Workstream Plan. The Audit Evidence Working Group will accordingly undertake further information gathering and research, and develop recommendations for possible further actions to be presented to the Board in the first half of 2020.

Agenda Item 12.2

NZ AUDITING AND ASSURANCE STANDARDS BOARD

DATE: 31 January 2020

TO: Members of the New Zealand Auditing and Assurance Standards Board

FROM: Peyman Momenan

SUBJECT: Domestic Update

Introduction

1. This Update summarises the significant news from Financial Market Authority, New Zealand Institute of Chartered Accountants and other organisations for the Board's information, for the period December 2019 to January 2020.

Financial Markets Authority (FMA)

1. The Financial Markets Authority has published a summary report on a review of custody arrangements in managed investment schemes (MIS) in response to questions raised by the International Monetary Fund (IMF).

   The thematic review, conducted by PwC, focused on retail funds and found 99.95% of MIS assets are being held in custody appropriately. Assets typically not held in custody were mainly bespoke assets, such as derivatives and term deposits[1].
   The review identified issues around the consistency and independence of custody arrangements.

2. This report by PwC looks at the extent to which the FMA is focused on the right activities in support of its main statutory objectives, opportunities for improving organisational performance, and options for funding FMA to support its broadening remit.

The New Zealand Institute of Chartered Accontants

1. Last year was certainly a big year in the reporting and assurance spaces. The final wave of the big new accounting standards came through and auditing was in the media and political spotlight in Australia and overseas.

   A number of initiatives were introduced in 2019 in both reporting and assurance and these will continue to gain traction. As a result, we can make some fairly confident predictions about what the key themes will be this year – many of which are interrelated. There will also be some attributes that overlay all of these – such as technology. Here are the top six topics we expect to dominate 2020 and beyond. (continue to read here).

2. CA ANZ and ICAS have published '[Steadying the Tiller: Insights from Leading Audit Committee Chairs']'. This reports the insights from interviews with audit committee chairs and a roundtable discussion with key stakeholders.

CPA Australia

1. No update for the period.

The Institute of Directors (IoD)

1. In his annual letter to CEOs around the world, Larry Fink (chair and CEO of the world's largest investment company, BlackRock) says that climate change will cause a transformational reallocation of capital towards sustainable investments and would bring about a fundamental reshaping of finance – ultimately helping achieve a more sustainable and inclusive capitalism for greater longer-term prosperity.

   Key points in Fink's letter include:
   - Equating climate risk to investment risk and announcing that BlackRock would place sustainability at the centre of its investment approach, for example exiting investments in coal production.
   - Re-iterating the importance of stakeholder interests and embracing purpose as 'the engine of long-term profitability.'
   - Asking that companies it invests in improve disclosures and report:
     - sustainability information in line with the Sustainability Accounting Standards Boards (SASB) guidelines; and
     - climate related risks in line with Taskforce on Climate Related Disclosures (TCFD) recommendations.
   - Giving notice that if companies don't effectively address material issues it will hold directors and management accountable (by voting against them).

   Fink concludes that the climate crisis is fundamentally different to the various financial crises and challenges of the past 50 years and that 'companies, investors and governments must prepare for a significant reallocation of capital' including in response to the increasing demands of the next generation for more transparency and action in order to achieve a more sustainable and inclusive capitalism.

2. The Ministry for the Environment and the Ministry of Business, Innovation and Employment sought feedback on a proposed climate-related financial disclosure regime for organisations.

   In our submission, we recognise the importance of climate-related financial disclosure and agree that the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD framework) would be appropriate in New Zealand.
   We also:
   - note that the 'comply or explain' approach to implementing the TCFD framework can support good governance
   - raise questions about how the proposed mandatory requirements will fit with the principles-based nature of the TCFD framework, and how it is intended to be implemented, monitored or enforced

- agree that disclosure should apply to listed issuers, banks, general insurers, asset owners and asset managers but we consider that there should be exemptions for some smaller organisations
- agree that mandatory assurance obligations should not be imposed at this stage, and
- encourage government guidance, education and support to help organisations report effectively.