NZ AUDITING AND ASSURANCE STANDARDS BOARD

AMENDMENTS TO INTERNATIONAL STANDARDS ON AUDITING (NEW ZEALAND): ADDRESSING DISCLOSURES IN THE AUDIT OF FINANCIAL STATEMENTS

This Standard was issued on 1 October 2015 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 October 2015.

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 amend International Standards on Auditing (New Zealand) as a result of changes made by the International Auditing and Assurance Standards Board (IAASB) to the International Standards on Auditing to reflect the amendments made to address disclosures in the audit of financial statements.

The amendments to the International Standards on Auditing (New Zealand) to address disclosures in the audit of financial statements are effective for periods ending on or after 15 December 2016. However, early adoption is permitted.

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Note: The footnote numbers within these amendments do not align with the actual footnote numbers of the standard that will be amended, and reference should be made to that compiled standard.

A: INTRODUCTION

This Amending Standard has been issued to amend International Standards on Auditing (New Zealand) as a result of changes made by the International Auditing and Assurance Standards Board (IAASB) to the International Standards on Auditing to reflect the amendments made to address disclosures in the audit of financial statements.

B: CHANGES TO THE INTERNATIONAL STANDARDS ON AUDITING – ADDRESSING DISCLOSURES IN THE AUDIT OF FINANCIAL STATEMENTS

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

New text is underlined and deleted text is struck through.

Definitions

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

    (f) Financial statements – A structured representation of historical financial information, including ~~related notes~~ disclosures, intended to communicate an entity's economic resources or obligations ~~assets, liabilities, or equity~~ 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 "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement. Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement, or in the notes, or incorporated therein by cross-reference. (Ref: Para.A1-A1a)

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Application and Other Explanatory Material

Definitions

Financial Statements (Ref: Para. 13(f))

A1. Some financial reporting frameworks may refer to an entity's economic resources or obligations in other terms. For example, these may be referred to as the entity's assets and liabilities, and the residual difference between them may be referred to as equity or equity interests.

A1a. Explanatory or descriptive information required to be included in the financial statements by the applicable financial reporting framework may be incorporated therein by cross- reference to information in another document, such as a management report or a risk report. "Incorporated therein by cross-reference" means cross-referenced from the financial statements to the other document, but not from the other document to the financial statements. Where the applicable financial reporting framework does not expressly prohibit the cross-referencing of where explanatory or descriptive information may be found, and the information has been appropriately cross-referenced, the information will form part of the financial statements.*

An Audit of Financial Statements

Scope of the Audit (Ref: Para. 3)

A1b. The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some jurisdictions, however, applicable law or regulation may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the ISAs (NZ) include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

* When the final standard is issued, this paragraph will become paragraph A2 and all subsequent paragraphs will be renumbered accordingly.

ISA (NZ) 210 ***Agreeing the Terms of Audit Engagements***

New text is underlined and deleted text is struck through.

Application and Other Explanatory Material

Preconditions for an Audit

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Agreement of the Responsibilities of Management (Ref: Para. 6(b))

A11. An audit in accordance with ISAs (NZ) is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph 6(b).[1] In certain jurisdictions, such responsibilities may be specified in law or regulation. In others, there may be little or no legal or regulatory definition of such responsibilities. ISAs (NZ) do not override law or regulation in such matters. However, the concept of an independent audit requires that the auditor's role does not involve taking responsibility for the preparation of the financial statements or for the entity's related internal control, and that the auditor has a reasonable expectation of obtaining the information necessary for the audit <u>(including information obtained from outside of the general and subsidiary ledgers)</u> in so far as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and recording the terms of the audit engagement in paragraphs 9-12.

Agreement on Audit Engagement Terms

…

Audit Engagement Letter or Other Form of Written Agreement[2] (Ref: Para. 10–11)

…

Form and Content of the Audit Engagement Letter

NZA23.1 The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on ISA (NZ) 200.[3] Paragraphs 6(b) and 12 of this ISA (NZ) deal with the description of the responsibilities of management. In addition to including the matters required by paragraph 10, an audit engagement letter may make reference to, for example:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, ISAs (NZ), and the Professional and Ethical Standards, and other pronouncements of professional bodies to which the auditor adheres.

1 ISA (NZ) 200, paragraph A2.

2 In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement.

3 ISA (NZ) 200, paragraphs 3-9.

- The form of any other communication of results of the audit engagement.
- The requirement for the auditor to communicate key audit matters in the auditor's report in accordance with proposed ISA (NZ) 701.[4]
- The fact that because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with ISAs (NZ).
- Arrangements regarding the planning and performance of the audit, including the composition of the engagement team.
- The expectation that those charged with governance will provide written representations (see also paragraph A13).
- <u>The expectation that management, will provide access to all information of which management is aware that is relevant to the preparation of the financial statements, including an expectation that management will provide access to information relevant to disclosures.</u>
- The agreement of management to make available to the auditor draft financial statements<u>, including all information relevant to their preparation, whether obtained from within or outside of the general and subsidiary ledgers (including all information relevant to the preparation of disclosures), and the other information,[5] if any</u> in time to allow the auditor to complete the audit in accordance with the proposed timetable.
- The agreement of management to inform the auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued.
- The basis on which fees are computed and any billing arrangements.
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein.

Appendix 1

(Ref: Para. A23-A24)

Example of an Audit Engagement Letter

…

[*The responsibilities of the directors and identification of the applicable financial reporting framework (for purposes of this example it is assumed that the auditor has not determined that the law or regulation prescribes those responsibilities in appropriate terms; the descriptions in paragraph 6(b) of this ISA (NZ) are therefore used).*]

4 ISA (NZ) 701, *Communication Key Audit Matters in the Independent Auditor's Report.*

5 <u>As defined in ISA (NZ) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information.*</u>

Our audit will be conducted on the basis that the [directors][6] acknowledge and understand that they have responsibility on behalf of the entity:

(a) For the preparation and fair presentation of the financial statements in accordance with New Zealand equivalents to International Financial Reporting Standards[7];

(b) For such internal control as [they] determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(c) To provide us with[8]:

  (i) Access to all information of which [management and the directors] are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

  (ii) Additional information that we may request from [management or the directors] for the purpose of the audit; and

  (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [the directors], written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

[*Other relevant information*]

[*Insert other information, such as fee arrangements, billings and other specific terms, as appropriate*.]

…

6 Use terminology as appropriate in the circumstances.

7 Or if appropriate, "For the preparation of financial statements that give a true and fair view in accordance with New Zealand equivalents to International Financial Reporting Standards."

8 <u>See paragraph A23 for examples of other matters relating to the responsibilities of those charged with governance that may be included.</u>

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

New text is underlined and deleted text is struck through.

Application and Other Explanatory Material

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Characteristics of Fraud (Ref: Para. 3)

…

A4. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as intentionally:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
- Inappropriately adjusting assumptions and changing judgements used to estimate account balances.
- Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
- Omitting, obscuring or misstating disclosures required by the applicable financial reporting framework or disclosures that are necessary to achieve fair presentation.
- Concealing~~, or not disclosing,~~ facts that could affect the amounts recorded in the financial statements.
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
- Altering records and terms related to significant and unusual transactions.

…

A11. The discussion may include such matters as:

- An exchange of ideas among engagement team members about how and where they believe the entity's financial statements (including the individual statements and the disclosures) may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.
- A consideration of circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.
- A consideration of the risk that management may attempt to present disclosures in a manner that may obscure a proper understanding of the matters disclosed (for example, by including too much immaterial information or by using unclear or ambiguous language).

- A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalise committing fraud.
- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.
- A consideration of any unusual or unexplained changes in behaviour or lifestyle of management or employees which have come to the attention of the engagement team.
- An emphasis on the importance of maintaining a proper state of mind throughout the audit regarding the potential for material misstatement due to fraud.
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
- A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statements to material misstatement due to fraud and whether certain types of audit procedures are more effective than others.
- A consideration of any allegations of fraud that have come to the auditor's attention.
- A consideration of the risk of management override of controls.

ISA (NZ) 300 ***Planning an Audit of Financial Statements***

New text is underlined and deleted text is struck through.

Requirements

Planning Activities

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).[9]

    (b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under ISA (NZ) 330.[10]

    (c) Other planned audit procedures that are required to be carried out so that the engagement complies with ISAs (NZ). (Ref: Para. A12-A12b)

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Application and Other Explanatory Material

The Audit Plan (Ref: Para. 9)

A12. The audit plan is more detailed than the overall audit strategy in that it includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

A12a. Determining the nature, timing and extent of planned risk assessment procedures and the further audit procedures, as they relate to disclosures is important in light of both the wide range of information and the level of detail that may be encompassed in those disclosures. Further, certain disclosures may contain information that is obtained from outside of the general and subsidiary ledgers, which may also affect the assessed risks and the nature, timing and extent of audit procedures to address them. [*]

A12b. Consideration of disclosures early in the audit assists the auditor in giving appropriate attention to, and planning adequate time for, addressing disclosures in the same way as classes of transactions, events and account balances. Early consideration may also help the auditor to determine the effects on the audit of:

[9] ISA (NZ) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and Its Environment*.

[10] ISA (NZ) 330, *The Auditor's Responses to Assessed Risks*.

[*] When the final standard is issued, this paragraph will become paragraph A13 and all subsequent paragraphs will be renumbered accordingly.

- Significant new or revised disclosures required as a result of changes in the entity's environment, financial condition or activities (for example a change in the required identification of segments and reporting of segment information arising from a significant business combination);
- Significant new or revised disclosures arising from changes in the applicable financial reporting framework;
- The need for the involvement of an auditor's expert to assist with audit procedures related to particular disclosures (for example disclosures related to pension or other retirement benefit obligations); and
- Matters relating to disclosures that the auditor may wish to discuss with those charged with governance.[11]

Appendix

(Ref: Para. 7-8, and A8-A11)

Considerations in Establishing the Overall Audit Strategy

This appendix provides examples of matters the auditor may consider in establishing the overall audit strategy. Many of these matters will also influence the auditor's detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. While some of the matters referred to below may be required by other ISAs (NZ), not all matters are relevant to every audit engagement and the list is not necessarily complete.

Characteristics of the Engagement

...

Reporting Objectives, Timing of the Audit, and Nature of Communications

...

…

Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

- The determination of materiality in accordance with ISA (NZ) 320[12] and, where applicable:
  - The determination of materiality for components and communication thereof to component auditors in accordance with ISA (NZ) 600.[13]
  - The preliminary identification of significant components and material classes of transactions, account balances and disclosures.
- Preliminary identification of areas where there may be a higher risk of material misstatement.

[11] ISA (NZ) 260 (Revised) *Communication with Those Charged with Governance*, paragraph A12.

[12] ISA (NZ) 320, *Materiality in Planning and Performing an Audit*.

[13] ISA (NZ) 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraphs 21-23 and 40(c).

- The impact of the assessed risk of material misstatement at the overall financial statement level on direction, supervision and review.
- The manner in which the auditor emphasises to engagement team members the need to maintain a questioning mind and to exercise professional scepticism in gathering and evaluating audit evidence.
- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them.
- The discussion of matters that may affect the audit with firm personnel responsible for performing other services to the entity.
- Evidence of management's commitment to the design, implementation and maintenance of sound internal control, including evidence of appropriate documentation of such internal control.
- <u>Changes within the applicable financial reporting framework, such as changes in accounting standards, which may involve significant new or revised disclosures.</u>
- Volume of transactions, which may determine whether it is more efficient for the auditor to rely on internal control.
- Importance attached to internal control throughout the entity to the successful operation of the business.
- <u>The process(es) management uses to identify and prepare the disclosures required by the applicable financial reporting framework, including disclosures containing information that is obtained from outside of the general and subsidiary ledgers.</u>
- Significant business developments affecting the entity, including changes in information technology and business processes, changes in key management, and acquisitions, mergers and divestments.
- Significant industry developments such as changes in industry regulations and new reporting requirements.
- ~~Significant changes in the financial reporting framework, such as changes in accounting standards.~~
- Other significant relevant developments, such as changes in the legal environment affecting the entity.

ISA (NZ) 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

New text is underlined and deleted text is struck through.

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

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

18. The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas: (Ref: Para.A89-A89a)

    (a) The classes of transactions in the entity's operations that are significant to the financial statements;

    (b) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;

    (c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;

    (d) How the information system captures events and conditions, other than transactions, that are significant to the financial statements;

    (e) The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures; and

    (f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments. (Ref: Para. A~~89~~90-A93)

    This understanding of the information system relevant to financial reporting shall include relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers.

26. For this purpose, the auditor shall:

    (a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures (including the quantitative or qualitative aspects of such disclosures) in the financial statements; (Ref: Para. A127-A128b)

    (b) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;

(c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: Para. A129-A131)

(d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement could result in a material misstatement. (Ref: Para.A131a)

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Application and Other Explanatory Material

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

NZA1.1 Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgement throughout the audit, for example, when:

- Assessing risks of material misstatement of the financial statements;
- Determining materiality in accordance with ISA (NZ) 320;[14]
- Considering the appropriateness of the selection and application of accounting policies, and the adequacy of financial statement disclosures;
- Identifying areas relating to amounts or disclosures in the financial statements where special audit consideration may be necessary, for example: related party transactions or ~~the appropriateness of~~ management's ~~use of the~~ assessment of the entity's ability to continue as a going concern; ~~assumption,~~ or when considering the business purpose of transactions;
- Developing expectations for use when performing analytical procedures;
- Responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence; and
- Evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and of the oral and written representations of management and those charged with governance.

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

A19. 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 internal control (including deficiencies in internal control).

14 ISA (NZ) 320, *Materiality in Planning and Performing an Audit*.

- Significant changes that the entity or its operations may have undergone since the prior financial period, which may assist the auditor in gaining a sufficient understanding of the entity to identify and assess risks of material misstatement.
- 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.

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

...

A21a. As part of the discussion among the engagement team required by paragraph 10, 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. Examples of 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.[*]

…

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

The Entity and Its Environment

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

…

Regulatory Factors

A26. Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment. Examples of matters the auditor may consider include:

- Accounting principles and industry specific practices.
- Regulatory framework for a regulated industry, including requirements for disclosures.

[*] When the final standard is issued, this paragraph will become paragraph A22 and all subsequent paragraphs will be renumbered accordingly.

- Legislation and regulation that significantly affect the entity's operations, including direct supervisory activities.
- Taxation (corporate and other).
- Government policies currently affecting the conduct of the entity's business, such as monetary, including foreign exchange controls, fiscal, financial incentives (for example, government aid programmes), and tariffs or trade restrictions policies.
- Environmental requirements affecting the industry and the entity's business.

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

A30. An understanding of the nature of an entity enables the auditor to understand such matters as:

- Whether the entity has a complex structure, for example with subsidiaries or other components in multiple locations. Complex structures often introduce issues that may give rise to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or special-purpose entities are accounted for appropriately, 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. This understanding assists the auditor in determining whether related party transactions have been appropriately identified, ~~and~~ accounted for, and adequately disclosed in the financial statements. ISA (NZ) 550[15] establishes requirements and provides guidance on the auditor's considerations relevant to related parties.

A31. Examples of matters that the auditor may consider when obtaining an understanding of the nature of the entity include:

...

- Financial reporting practices– such as:
  - Accounting principles and industry specific practices, including for industry-specific significant ~~categories~~ 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).
  - Revenue recognition ~~practices~~.
  - Accounting for fair values.
  - Foreign currency assets, liabilities and transactions.
  - Accounting for unusual or complex transactions including those in controversial or emerging areas (for example, accounting for share-based compensation).

A32. Significant changes in the entity from prior periods may give rise to, or change, risks of material misstatement.

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15 ISA (NZ) 550, *Related Parties*.

…

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

A80. Some elements of an entity's control environment have a pervasive effect on assessing the risks of material misstatement. For example, an entity's control consciousness is influenced significantly by those charged with governance, because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment in relation to participation by those charged with governance is therefore influenced by such matters as:

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

...

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

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

...

A89a. Financial statements may contain information that is obtained from outside of the general and subsidiary ledgers. Examples of such information may include:

- Information obtained from lease agreements disclosed in the financial statements, such as renewal options or future lease payments.
- 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 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 use of going concern basis, 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[16].

A89b. The understanding of the information system relevant to financial reporting required by paragraph 18 of this ISA (NZ) (including the understanding of relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers) is a matter of the auditor's professional judgement. For example, 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.

Considerations specific to smaller entities

A93. The information system~~s,~~ and related business processes relevant to financial reporting in small entities, including relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers, is ~~are~~ likely to be less sophisticated than in larger entities, but ~~their~~ its role is just as significant. Small entities with active management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the entity's information system~~s~~ relevant to financial reporting ~~and processes~~ may therefore be easier in an audit of smaller entities, and may be more dependent on enquiry than on review of documentation. The need to obtain an understanding, however, remains important.

…

A99a. Control activities relevant to the audit may 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, in addition to controls that address the risks related to account balances and transactions. Such control activities may relate to information included in the financial statements that is obtained from outside of the general and subsidiary ledgers.

…

[16] Paragraphs 19-20 of ISA (NZ) 570 (Revised).

Identifying and Assessing the Risks of Material Misstatement

Assessment of Risks of Material Misstatement at the Financial Statement Level (Ref: Para. 25 (a))

…

A119. Risks at the financial statement level may derive in particular from a deficient control environment (although these risks may also relate to other factors, such as declining economic conditions). For example, deficiencies such as a ~~management's~~ lack of management competence or lack of oversight over the preparation of the financial statements may have a more pervasive effect on the financial statements and may require an overall response by the auditor.

The Use of Assertions

A123. In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding ~~the~~ recognition, measurement, and presentation of classes of transactions and events, account balances and disclosures. ~~of the various elements of financial statements and related disclosures.~~

A123a. The auditor may use the assertions as described ~~above~~ in paragraph A124 (a)-(b) below or may express them differently provided all aspects described ~~above~~ below have been covered. For example, 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. [Moved from paragraph A125]

Assertions about classes of transactions, account balances and related disclosures.

A124. Assertions used by the auditor ~~to~~in considering the different types of potential misstatements that may occur may fall into the following ~~three~~ categories ~~and may take the following forms~~:

(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, ~~V~~valuation and allocation—assets, liabilities, and equity ~~interests are~~ have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments~~— are~~ 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.

~~(c) Assertions about presentation and disclosure:~~

~~(i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.~~

~~(ii) Completeness—all disclosures that should have been included in the financial statements have been included.~~

~~(iii) Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.~~

~~(iv) Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.~~

Assertions about other disclosures

A124a. The assertions described in paragraph A124 (a)-(b) above, adapted as appropriate, may also be used by the auditor in considering the different types of potential misstatements that may occur in disclosures not directly related to recorded classes of transactions, events or account balances. As an example of such a disclosure, the entity may be required 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.

~~A125. The auditor may use the assertions as described above or may express them differently provided all aspects described above have been covered. For example, the auditor may choose to combine the assertions about transactions and events with the assertions about account balances.~~ [Moved to paragraph A123a]

...

Process of Identifying Risks of Material Misstatement (Ref: Para. 26(a))

A127. Information gathered by performing risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, is used as audit evidence to support the risk assessment. The risk assessment determines the nature, timing, and extent of further audit procedures to be performed. In identifying the risks of material misstatement in the financial statements, the auditor exercises professional scepticism in accordance with ISA (NZ) 200.[17]

A128. Appendix 2 provides examples of conditions and events that may indicate the existence of risks of material misstatement, including risks of material misstatement relating to disclosures.

A128a. As explained in ISA (NZ) 320,[18] 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 reporting needs of users of the financial statements.[19]

A128b. The auditor's consideration of disclosures in the financial statements when identifying risks includes quantitative and qualitative disclosures, the misstatement of which could be material (i.e., in general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole). Depending on the circumstances of the entity and the engagement, examples of disclosures that that will have qualitative aspects and that may be relevant when assessing the risks of material misstatement 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.

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[17] 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 15.

[18] ISA (NZ) 320, *Materiality in Planning and Performing an Audit*, paragraph A1.

[19] ISA (NZ) 320, paragraph 4.

- 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.

Considerations specific to smaller entities

A128c. Disclosures in the financial statements of smaller entities may be less detailed or less complex (e.g., some financial reporting frameworks allow smaller entities to provide fewer 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, including internal control, as it relates to disclosures.

Material Misstatements

A131a. Potential misstatements in individual statements and disclosures may be judged to be material due to size, nature or circumstances. (Ref: Para.26(d))

Appendix 2

(Ref: Para. A40, A128)

Conditions and Events That May Indicate Risks of Material Misstatement

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

- Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies.

…

- Deficiencies in internal control, especially those not addressed by management.
- Incentives for management and employees to engage in fraudulent financial reporting.
- Inconsistencies between the entity's IT strategy and its business strategies.

…

- Accounting measurements that involve complex processes.
- Events or transactions that involve significant measurement uncertainty, including accounting estimates, and related disclosures.
- Omission, or obscuring, of significant information in disclosures.
- Pending litigation and contingent liabilities, for example, sales warranties, financial guarantees and environmental remediation.

ISA (NZ) 320 *Materiality in Planning and Performing an Audit*

New text is underlined and deleted text is struck through.

Introduction

Materiality in the Context of an Audit

6. In planning the audit, the auditor makes judgements about ~~the size of~~ misstatements that will be considered material. These judgements provide a basis for:

   (a) Determining the nature, timing and extent of risk assessment procedures;

   (b) Identifying and assessing the risks of material misstatement; and

   (c) Determining the nature, timing and extent of further audit procedures.

   The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. ~~Although~~ It is not practicable to design audit procedures to detect all misstatements that could be material solely because of their nature. However, consideration of the nature of potential misstatements in disclosures is relevant to the design of audit procedures to address risks of material misstatement[20]. In addition, when evaluating the effect on the financial statements of all uncorrected misstatements, the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence~~, when evaluating their effect on the financial statements~~.[21] (Ref: Para. A1a)

Application and Other Explanatory Material

Materiality in the Context of an Audit (Ref: Para. 6)

A1a. Identifying and assessing the risks of material misstatement[22] involves the use of professional judgement to identify those classes of transactions, account balances and disclosures, including qualitative disclosures, the misstatement of which could be material (i.e., in general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole). When considering whether misstatements in qualitative disclosures could be material, the auditor may identify relevant factors such as:

- The circumstances of the entity for the period (for example, the entity may have undertaken a significant business combination during the period).

[20] ISA (NZ) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*, *paragraphs* A128a – A128b.

[21] ISA (NZ) 450, paragraph A16.

[22] ISA (NZ) 315 (Revised), paragraph 25, requires the auditor to identify and assess the risk of material misstatement at the financial statement and assertion level.

- The applicable financial reporting framework, including changes therein (for example, a new financial reporting standard may require new qualitative disclosures that are significant to the entity).
- Qualitative disclosures that are important to users of the financial statements because of the nature of an entity (for example, liquidity risk disclosures may be important to users of the financial statements for a financial institution).

...

Determining Materiality and Performance Materiality When Planning the Audit

...

Materiality Level or Levels for Particular Classes of Transactions, Account Balances or Disclosures (Ref: Para. 10)

A10. Factors that may indicate the existence of one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:

- Whether law, regulation or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions, ~~and~~ the remuneration of management and those charged with governance and sensitivity analysis for fair value accounting estimates with high estimation uncertainty).
- The key disclosures in relation to the industry in which the entity operates (for example, research and development costs for a pharmaceutical company).
- Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements (for example, disclosures about segments or a significant business combination ~~newly acquired business~~).

ISA (NZ) 330 *The Auditor's Responses to Assessed Risks*

New text is underlined and deleted text is struck through.

Requirements

…

Substantive Procedures

…

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 <u>information in</u> the financial statements<u>, </u>with the underlying accounting records<u>, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers</u>; and

    (b) Examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: Para. A52)

…

Adequacy of Presentation, ~~and~~ Disclosure <u>of the Financial Statements</u>

24. The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements~~, including the related disclosures,~~ is in accordance with the applicable financial reporting framework. <u>In making this evaluation, the auditor shall consider whether the financial statements are presented in a manner that reflects the appropriate:</u>

    - <u>Classification and description of financial information and the underlying transactions, events and conditions; and</u>

    - <u>Presentation, structure and content of the financial statements.</u> (Ref: Para. A59)

…

Documentation

30. The auditor's documentation shall demonstrate that <u>information in</u> the financial statements agree<u>s</u> or reconcile<u>s</u> with the underlying accounting records<u>, including agreeing or reconciling disclosures, whether such information is obtained from within or outside the general and subsidiary ledgers.</u>

***

Application and Other Explanatory Material

…

Timing

…

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 ~~to~~ 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;
- 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.

…

Substantive Procedures (Ref: Para. 18)

…

Substantive Procedures Related to the Financial Statement Closing Process (Ref: Para. 20~~(b)~~)

A52. The nature, and also the extent, of the auditor's substantive procedures related to the financial statement closing process ~~examination of journal entries and other adjustments~~ depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement.

…

Adequacy of Presentation ~~and Disclosure~~ of the Financial Statements (Ref: Para. 24)

A59. Evaluating the ~~overall~~ appropriate presentation, arrangement and content of the financial statements, ~~including the related disclosures, relates to whether the individual financial statements are presented in a manner that reflects the appropriate classification and description of financial information, and the form, arrangement, and~~

~~content of the financial statements and their appended notes. This~~ includes, for example, consideration of the terminology used as required by the applicable financial reporting framework, the ~~amount~~ level of detail ~~given~~ provided, ~~classification of items in the statements,~~ the aggregation and disaggregation of amounts and the bases of amounts set forth.

ISA (NZ) 450 *Evaluation of Misstatements Identified during the Audit*

New text is underlined and deleted text is struck through.

Definitions

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

   (a) Misstatement – A difference between the <u>reported </u>amount, classification, presentation, or disclosure of a ~~reported~~ financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud. (Ref: Para. A1)

   When the auditor expresses an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgement, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view.

***

Application and Other Explanatory Material

Definition of Misstatement (Ref: Para. 4(a))

A1. Misstatements may result from:

   (a) An inaccuracy in gathering or processing data from which the financial statements are prepared;

   (b) An omission of an amount or disclosure<u>, including inadequate or incomplete disclosures, and those disclosures required to meet disclosure objectives of certain financial reporting frameworks as applicable</u>[23];

   (c) An incorrect accounting estimate arising from overlooking, or clear misinterpretation of, facts; ~~and~~

   (d) Judgements of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

   <u>(e) An inappropriate classification, aggregation or disaggregation, of information; and</u>

   <u>(f) For financial statements prepared in accordance with a fair presentation framework, the omission of a disclosure necessary for the financial statements to</u>

23 <u>For example, New Zealand equivalents to International Financial Reporting Standard 7, Financial Instruments: Disclosures, paragraph 42H states that "an entity shall disclose any additional information that it considers necessary to meet the disclosure objectives in paragraph…"</u>

achieve fair presentation beyond disclosures specifically required by the framework.[24]

Examples of misstatements arising from fraud are provided in ISA (NZ) 240.[25]

Accumulation of Identified Misstatements (Ref: Para. 5)

"Clearly Trivial"

A2. ~~The auditor may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements.~~ Paragraph 5 of this ISA (NZ) requires the auditor to accumulate misstatements identified during the audit other than those that are clearly trivial. "Clearly trivial" is not another expression for "not material." ~~Matters~~ Misstatements that are clearly trivial will be of a wholly different (smaller) order of magnitude, or of a wholly different nature than those that would be determined to be material, ~~than materiality determined in accordance with ISA (NZ) 320, and will be matters~~ and will be misstatements that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the ~~matter~~ misstatement is considered not to be clearly trivial.

Misstatements in Individual Statements

A2a. The auditor may designate an amount below which misstatements of amounts in the individual statements would be clearly trivial, and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements. However, misstatements of amounts that are above the designated amount are accumulated as required by paragraph 5 of this ISA (NZ). In addition, misstatements relating to amounts may not be clearly trivial when judged on criteria of nature or circumstances, and, if not, are accumulated as required by paragraph 5 of this ISA (NZ).*

Misstatements in Disclosures

A2b. Misstatements in disclosures may also be clearly trivial whether taken individually or in aggregate, and whether judged by any criteria of size, nature or circumstances. Misstatements in disclosures that are not clearly trivial are also accumulated to assist the auditor in evaluating the effect of such misstatements on the relevant disclosures and the financial statements as a whole. Paragraph A13a of this ISA (NZ) provides examples of where misstatements in qualitative disclosures may be material.

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24 For example, NZ IFRS requires an entity to provide additional disclosures when compliance with the specific requirements in NZ IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance (New Zealand equivalents to International Accounting Standard 1, *Presentation of Financial Statements,* paragraph 17 (c))

25 ISA (NZ) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraphs A1-A6.

* When the final standard is issued, this paragraph will become paragraph A3 and all subsequent paragraphs will be renumbered accordingly.

Accumulation of Misstatements

A2c. Misstatements by nature or circumstances, accumulated as described in paragraphs A2a–A2b, cannot be added together as is possible in the case of misstatements of amounts. Nevertheless, the auditor is required by paragraph 11 of this ISA (NZ) to evaluate those misstatements individually and in aggregate (i.e., collectively with other misstatements) to determine whether they are material.

A3. To assist the auditor in evaluating the effect of misstatements accumulated during the audit and in communicating misstatements to management and those charged with governance, it may be useful to distinguish between factual misstatements, judgemental misstatements and projected misstatements.

- Factual misstatements are misstatements about which there is no doubt.
- Judgemental misstatements are differences arising from the judgements of management including those concerning recognition, measurement, presentation and disclosure in the financial statements (including ~~accounting estimates that the auditor considers unreasonable or~~ the selection or application of accounting policies) that the auditor considers unreasonable or inappropriate.
- Projected misstatements are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn. Guidance on the determination of projected misstatements and evaluation of the results is set out in ISA (NZ) 530.[26]

Communication and Correction of Misstatements (Ref: Para. 8-9)

A7. Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the ~~items~~ classes of transactions, account balances and disclosures are misstated~~ments~~, inform the auditor if it disagrees, and take action as necessary. Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the misstatements and to take the necessary action.

…

Evaluating the Effect of Uncorrected Misstatements (Ref: Para. 10-11)

…

A13. Each individual misstatement of an amount is considered to evaluate its effect on the relevant classes of transactions, account balances or disclosures, including whether the materiality level for that particular class of transactions, account balance or disclosure, if any, has been exceeded.

A13a. In addition, each individual misstatement of a qualitative disclosure is considered to evaluate its effect on the relevant disclosure(s), as well as its overall effect on the financial statements as a whole. The determination of whether a misstatement(s) in a qualitative disclosure is material, in the context of the applicable financial reporting framework and the specific circumstances of the entity, is a matter that involves the

[26] ISA (NZ) 530, *Audit Sampling*, paragraphs 14-15.

exercise of professional judgement. Examples where such misstatements may be material include:

- Inaccurate or incomplete descriptions of information about the objectives, policies and processes for managing capital for entities with insurance and banking activities.
- The omission of information about the events or circumstances that have led to an impairment loss (e.g., a significant long-term decline in the demand for a metal or commodity) in an entity with mining operations.
- The incorrect description of an accounting policy relating to a significant item in the statement of financial position, the statement of comprehensive income, the statement of changes in equity or the statement of cash flows.
- The inadequate description of the sensitivity of an exchange rate in an entity that undertakes international trading activities. [*]

A13b. In determining whether uncorrected misstatements by nature are material as required by paragraph 11 of this ISA (NZ), the auditor considers uncorrected misstatements in amounts and disclosures. Such misstatements may be considered material either individually, or when taken in combination with other misstatements. For example, depending on the misstatements identified in disclosures, the auditor may consider whether:

(a) Identified errors are persistent or pervasive; or

(b) A number of identified misstatements are relevant to the same matter, and considered collectively may affect the users' understanding of that matter.

This consideration of accumulated misstatements is also helpful when evaluating the financial statements in accordance with paragraph 13(d) of ISA (NZ) 700 (Revised),[27] which requires the auditor to consider whether the overall presentation of the financial statements has been undermined by including information that is not relevant or that obscures a proper understanding of the matters disclosed.

…

A17. ISA (NZ) 240[28] explains how the implications of a misstatement that is, or may be, the result of fraud ought to be considered in relation to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements. Depending on the circumstances, misstatements in disclosures could also be indicative of fraud, and, for example, may arise from:

- Misleading disclosures that have resulted from bias in management's judgements; or
- Extensive duplicative or uninformative disclosures that are intended to obscure a proper understanding of matters in the financial statements.

* When the final standard is issued, this paragraph will become paragraph A14 and all subsequent paragraphs will be renumbered accordingly.

27 ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*.

28 ISA (NZ) 240, paragraph 35.

When considering the implications of misstatements in classes of transactions, account balances and disclosures, the auditor exercises professional scepticism in accordance with ISA (NZ) 200.[29]

[29] ISA (NZ) 200, paragraph 15.

C: CONFORMING AMENDMENTS TO OTHER ISAs (NZ)

Note: The following are conforming amendments to other ISAs (NZ) as a result of the approval of the amendments to the ISAs (NZ) for "Addressing Disclosures in the Audit of Financial Statements." These amendments will become effective at the same time as the amendments to the ISAs (NZ) in this document, and are shown with marked changes from the latest approved versions of the ISAs (NZ) that are amended, including conforming amendments from the Auditor Reporting enhancements. The footnote numbers within these amendments may not align with the amended ISAs (NZ), and reference should be made to those ISAs (NZ).

ISA (NZ) 540 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

New text is underlined and deleted text is struck through.

A19. Enquiries of management about changes in circumstances may include, for example, enquiries about whether:

- The entity has engaged in new types of transactions that may give rise to accounting estimates.
- Terms of transactions that gave rise to accounting estimates have changed.
- Accounting policies relating to accounting estimates have changed, as a result of changes ~~to~~ within the requirements of the applicable financial reporting framework or otherwise.

ISA (NZ) 580 *Written Representations*

New text is underlined and deleted text is struck through.

Appendix 2

(Ref: Para. A21)

Illustrative Representation Letter

The following illustrative letter includes written representations that are required by this and other ISAs (NZ) in effect for audits of financial statements for periods beginning on or after 1 July 2011. It is assumed in this illustration that the applicable financial reporting framework is generally accepted accounting practice in New Zealand; the requirement of ISA (NZ) 570 (Revised) [30] to obtain a written representation is not relevant; and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

30 ISA (NZ) 570 (Revised), *Going Concern*.

(Entity Letterhead)

(To Auditor) (Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Limited for the year ended December 31, 20XX[31] for the purpose of expressing an opinion as to whether the financial statements comply with generally accepted accounting practice in New Zealand and give a true and fair view of the financial position of ABC Limited as at December 31, 20XX and of the results of its operations and its cash flows for the year then ended.

We confirm that (*to the best of our knowledge and belief, having made such enquiries as we considered necessary for the purpose of appropriately informing ourselves*):

Financial Statements

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [insert date], for the preparation of the financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the financial position of ABC Limited as at December 31, 20XX[32] and of the results of its operations and its cash flows for the year then ended.
- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable. (ISA (NZ) 540)
- Related party relationships and transactions have been appropriately accounted for and disclosed in the financial statements in accordance with the requirements of the applicable financial reporting framework. (ISA (NZ) 550)
- All events subsequent to the date of the financial statements which require adjustment or disclosure have been adjusted or disclosed. (ISA (NZ) 560)
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (ISA (NZ) 450)
- [Any other matters that the auditor may consider appropriate (see paragraph A10 of this ISA (NZ)).]

Information Provided

- We have provided you with[33]:
    - Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
    - Additional information that you have requested from us for the purpose of the audit; and

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31 Where the auditor reports on more than one period, the auditor adjusts the date so that the letter pertains to all periods covered by the auditor's report.

32 Where the auditor reports on more than one period, the auditor adjusts the date so that the letter pertains to all periods covered by the auditor's report.

33 If the auditor has included other matters relating to the responsibilities of those charged with governance in the audit engagement letter in accordance with ISA (NZ) 210, *Agreeing the Terms of Audit Engagements*, consideration may be given to including these matters in the written representations from those charged with governance.

    - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. (ISA (NZ) 240)
- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
    - Management;
    - Employees who have significant roles in internal control; or
    - Others where the fraud could have a material effect on the financial statements. (ISA (NZ) 240)
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (ISA (NZ) 240)
- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements. (ISA (NZ) 250)
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (ISA (NZ) 550)
- [Any other matters that the auditor may consider necessary (see paragraph A11 of this ISA (NZ)).]

Director Director

D: EFFECTIVE DATE

The changes are effective for periods ending on or after 15 December 2016. However, early adoption is permitted.