

Supplement to Agenda Item 3-C

This Supplement sets out specific paragraph references in the International Standards on Auditing (ISAs) where conforming amendments are expected to be needed based on the proposed changes to ISA 315 (Revised)¹ set out in **Agenda Items 3-A and 3-B**, with a description of the changes that will be made.² In some instances, extracts of the relevant paragraphs have been presented to clarify the proposed conforming amendment – see **Appendices 1 and 2**.

As further explained in the issues paper (paragraphs 73 and 74 of **Agenda Item 3**), the Task Force has proposed to:

- Retain the definitions of ‘deficiency in internal control’ and ‘significant deficiency in internal control’ in ISA 265³ and other ISAs, with the exception of ISA 315 (Revised). The Task Force is of the view that because each definition explains that the deficiency relates to a control or combination of controls, the terms ‘control deficiency’ and ‘significant control deficiency’ are also appropriate. It has therefore been proposed that the Handbook Glossary be amended to acknowledge that these terms are also used in some ISAs with the same meaning. For example, the term ‘significant deficiency in internal control’ is referred to as ‘significant control deficiency’ in ISA 315 (Revised).
- Retain the term ‘internal control,’ as opposed to the ‘system of internal control,’ throughout the ISAs (with the exception of ISA 315 (Revised)), unless the context in which the term is used is referring to the auditor’s understanding of the system of internal control in accordance with ISA 315 (Revised) (e.g., used in context of a specific component of the system of internal control or is related to the auditor performing the requirements in accordance with ISA 315 (Revised)). With specific reference to the auditor reporting standards (ISA 700 (Revised),⁴ ISA 701,⁵ ISA 800 (Revised),⁶ ISA 805 (Revised)⁷ and ISA 810 (Revised)⁸), including the template auditor’s reports within these standards, the Task Force has previously proposed to the Board to not make any changes for the term ‘internal control’ at this time. In light of the expected post-implementation review and possible further changes that may result, the Task Force is of the view that any changes in respect of ‘internal control’ are made at the same time as any other changes that may come out of the planned post-implementation review of the Auditor Reporting standards.

The proposed changes to the other ISAs are presented in the table that follows.

¹ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

² Agenda Item 3-C presents the ISAs where greater volume of changes are expected (ISA 200, ISA 240 and ISA 330). This Supplement sets out specific paragraph references in the other ISAs (not presented) where conforming amendments will be proposed.

³ ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

⁴ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

⁵ ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

⁶ ISA 800 (Revised), *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*

⁷ ISA 805 (Revised), *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*.

⁸ ISA 810 (Revised), *Engagements to Report on Summary Financial Statements*

Extant Term in the ISAs	Change Made in Proposed ISA 315 (Revised)	Relevant Paragraph(s) Where Change is Proposed
Changes to Names of Components of the System of Internal Control		
Monitoring of controls (ISA 315 (Revised), para's 22–24)	The entity's process to monitor the system of internal control (ISA 315 (Revised), para's 17A–17C)	<u>ISA 210:</u> ⁹ <ul style="list-style-type: none"> • Para. A18 (refer to Appendix 1) <u>ISA 402:</u> ¹⁰ <ul style="list-style-type: none"> • Para. A33 – last bullet • Para. A34
The information system, including the related business processes, relevant to financial reporting, and communication (ISA 315 (Revised), para. 18)	The information system, and communication (ISA 315 (Revised), para. 18)	<u>ISA 210:</u> <ul style="list-style-type: none"> • Para. A18 (refer to Appendix 1)
Other Changes		
Monitoring of controls ¹¹ (ISA 315 (Revised), para's 22–24)	Controls within the entity's process to monitor the system of internal control (ISA 315 (Revised), para's 17A–17C)	<u>ISA 402:</u> <ul style="list-style-type: none"> • A39 – first bullet <u>ISA 600:</u> ¹² <ul style="list-style-type: none"> • Appendix 2, para. 1, 8th bullet (refer to Appendix 1)
Control activities (ISA 315 (Revised), para. 20)	Controls (ISA 315 (Revised), para. 19A)	<u>ISA 250 (Revised):</u> ¹³ <ul style="list-style-type: none"> • Para. A23 <u>ISA 265:</u> <ul style="list-style-type: none"> • Para A3 (2nd and 3rd sentences) (refer to Appendix 1) <u>ISA 500:</u> ¹⁴ <ul style="list-style-type: none"> • Para. A17

⁹ ISA 210, *Agreeing the Terms of Audit Engagements*

¹⁰ ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

¹¹ Where this is used to describe what the entity does, as opposed to the name of the component

¹² ISA 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*

¹³ ISA 250 (Revised), *Consideration of laws and Regulations in an Audit of Financial Statements*

¹⁴ ISA 500, *Audit Evidence*

Extant Term in the ISAs	Change Made in Proposed ISA 315 (Revised)	Relevant Paragraph(s) Where Change is Proposed
		<p><u>ISA 501</u>:¹⁵</p> <ul style="list-style-type: none"> • Para. A4 <p><u>ISA 550</u>:¹⁶</p> <ul style="list-style-type: none"> • Para. A20 <p><u>ISA 600</u>:</p> <ul style="list-style-type: none"> • Appendix 2, para. 1 (7th bullet) • Appendix 5, Matters that are relevant to the conduct of the work of the component auditor (1st bullet) <p><u>ISA 610</u>:¹⁷</p> <ul style="list-style-type: none"> • Para. A3 • Para. A10
Control activities ¹⁸ (ISA 315 (Revised), para. 20)	Controls in the control activities component (ISA 315 (Revised), para. 19A)	<p><u>ISA 265</u>:</p> <ul style="list-style-type: none"> • Para. A3 (first sentence) (refer to Appendix 1)
Relevant control activities (ISA 315 (Revised), para. 20)	Controls relevant to the audit (ISA 315 (Revised), para. 19A)	<p><u>ISA 300</u>:¹⁹</p> <ul style="list-style-type: none"> • Para. A21
The auditor shall determine whether changes have occurred since the previous audit that may affect its relevance to the current audit. (ISA 315 (Revised), para. 9)	The auditor shall evaluate whether such information remains relevant and reliable as audit evidence for the current audit. (ISA 315 (Revised), para. 9)	<p><u>ISA 500</u>:</p> <ul style="list-style-type: none"> • Para. A1
Internal control (ISA 315 (Revised), para. 4(c))	The system of internal control (ISA 315 (Revised), para. 4(f))	<p><u>ISA 210</u>:</p> <ul style="list-style-type: none"> • Para. A18 (refer to Appendix 1)

¹⁵ ISA 501, *Audit Evidence – Specific Considerations for Selected Items*

¹⁶ ISA 550, *Related Parties*

¹⁷ ISA 610, *Using the Work of Internal Auditors*

¹⁸ The proposed change in respect of this reference to ‘control activities’ is slightly different when compared to the proposed change in the previous row. This is due to the particular construction of the first sentence of ISA 265 paragraph A3; however, the meaning of ‘controls’ remains the same. Also refer to Appendix 1.

¹⁹ ISA 300, *Planning an Audit of Financial Statements*

Extant Term in the ISAs	Change Made in Proposed ISA 315 (Revised)	Relevant Paragraph(s) Where Change is Proposed
		<u>ISA 265:</u> <ul style="list-style-type: none"> • Para. 1 (second sentence) • Para. 2 (first sentence) <u>ISA 620:</u> ²⁰ <ul style="list-style-type: none"> • Para. A4 (first bullet)
Internal control relevant to the audit (ISA 315 (Revised), para. 12)	Controls relevant to the audit (ISA 315 (Revised), para. 13)	<u>ISA 402:</u> <ul style="list-style-type: none"> • Para 14(b)
Internal control relevant to the audit. (ISA 315 (Revised), para. 12)	System of internal control relevant to financial reporting (ISA 315 (Revised), para. 12)	<u>ISA 260 (Revised):</u> ²¹ <ul style="list-style-type: none"> • Para A13, 3rd bullet <u>ISA 265:</u> <ul style="list-style-type: none"> • Para 2 (first sentence) <u>ISA 402:</u> <ul style="list-style-type: none"> • Para. 1 • Para. 7(a) • Para. 10 (refer to Appendix 1)
Extant elements of the auditor's understanding of the 'entity and its environment' ISA 315 (Revised), para. 11 (refer to Appendix 2)	Revised elements of the auditor's understanding of the 'entity and its environment' ISA 315 (Revised), para. 11 (refer to Appendix 2)	All the changes in this section are presented in Appendix 2 <u>ISA 550:</u> <ul style="list-style-type: none"> • Para. A12 <u>ISA 600:</u> <ul style="list-style-type: none"> • Para. A23 <u>ISA 720 (Revised):</u> ²² <ul style="list-style-type: none"> • Para. A31
Understanding the entity and its environment ²³ (ISA 315 (Revised), para. 11)	Understanding the entity and its environment, the applicable financial reporting framework and the system of internal control (ISA 315 (Revised), para. 5)	<u>ISA 230:</u> ²⁴ <ul style="list-style-type: none"> • Para. A17 (refer Appendix 1) <u>ISA 600:</u> <ul style="list-style-type: none"> • Para. 17

²⁰ ISA 620, *Using the Work of an Auditor's Expert*

²¹ ISA 260 (Revised), *Communication with Those Charged with Governance*

²² ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

²³ When reference is made to the auditor's understanding of the entity and its environment, and in the specific context used, are intended to be inclusive of the auditor's understanding of internal control

²⁴ ISA 230, *Audit Documentation*

Extant Term in the ISAs	Change Made in Proposed ISA 315 (Revised)	Relevant Paragraph(s) Where Change is Proposed
		<p><u>ISA 620:</u></p> <ul style="list-style-type: none"> • Para. A4 (first bullet) <p><u>ISA 720 (Revised):</u></p> <ul style="list-style-type: none"> • Para. A31 (refer Appendix 2)
<p>Require special audit consideration (in context of significant risks) (ISA 315 (Revised), para. 4(e))</p>	<p><i>Change as appropriate or delete</i> (ISA 315 (Revised), para. 4(e))</p>	<p>All the changes in this section are presented in Appendix 1</p> <p><u>ISA 260 (Revised):</u></p> <ul style="list-style-type: none"> • Para. A12 <p><u>ISA 550:</u></p> <ul style="list-style-type: none"> • Para. A28 <p><u>ISA 600:</u></p> <ul style="list-style-type: none"> • Para. A6 <p><u>ISA 610:</u></p> <ul style="list-style-type: none"> • Para. A21 <p><u>ISA 701:</u></p> <ul style="list-style-type: none"> • Para. A20
<p>Relevant controls (ISA 315 (Revised), para 13 – heading)</p>	<p>Controls relevant to the audit (ISA 315 (Revised), para. 13)</p>	<p><u>ISA 402:</u></p> <ul style="list-style-type: none"> • Para. 10 (refer Appendix 1) • Para. 12 (c) and (d) • Para. A19 • Para. A22 (hanging paragraph) • Para. A29 • Para. A30 (1st and 2nd sentences) • Para. A33
<p>Relevant controls (ISA 315 (Revised), para 13 – heading)</p>	<p><i>Change as appropriate</i></p>	<p><u>ISA 530:</u>²⁵</p> <ul style="list-style-type: none"> • Appendix 2, factor 1 (refer Appendix 1) <p><u>ISA 550:</u></p> <ul style="list-style-type: none"> • Para. A34 – last sentence (refer Appendix 1)

²⁵ ISA 530, *Audit Sampling*

Extant Term in the ISAs	Change Made in Proposed ISA 315 (Revised)	Relevant Paragraph(s) Where Change is Proposed
Identifying and assessing the risks of material misstatement through understanding the entity and its environment (name of standard)	Identifying and assessing the risks of material misstatement	<p><u>ISA 210:</u></p> <ul style="list-style-type: none"> • Footnote 14 <p><u>ISA 220:</u>²⁶</p> <ul style="list-style-type: none"> • Footnote 13 <p><u>ISA 230:</u></p> <ul style="list-style-type: none"> • Footnote 5 • Appendix <p><u>ISA 250:</u>²⁷</p> <ul style="list-style-type: none"> • Footnote 4 <p><u>ISA 260 (Revised):</u></p> <ul style="list-style-type: none"> • Footnote 4 <p><u>ISA 265:</u></p> <ul style="list-style-type: none"> • Footnote 1 <p><u>ISA 300:</u></p> <ul style="list-style-type: none"> • Footnote 4 <p><u>ISA 320:</u>²⁸</p> <ul style="list-style-type: none"> • Footnote 3 <p><u>ISA 402:</u></p> <ul style="list-style-type: none"> • Footnote 1 <p><u>ISA 500:</u></p> <ul style="list-style-type: none"> • Footnote 1 <p><u>ISA 505:</u>²⁹</p> <ul style="list-style-type: none"> • Footnote 14 <p><u>ISA 510:</u>³⁰</p> <ul style="list-style-type: none"> • Footnote 4 <p><u>ISA 520:</u>³¹</p> <ul style="list-style-type: none"> • Footnote 1

²⁶ ISA 220, *Quality Control for an Audit of Financial Statements*

²⁷ ISA 250, (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

²⁸ ISA 320, *Materiality in Planning and Performing an Audit*

²⁹ ISA 505, *External Confirmations*

³⁰ ISA 510, *Opening Balances*

³¹ ISA 520, *Analytical Procedures*

Extant Term in the ISAs	Change Made in Proposed ISA 315 (Revised)	Relevant Paragraph(s) Where Change is Proposed
		<p><u>ISA 550:</u></p> <ul style="list-style-type: none"> • Footnote 1 <p><u>ISA 570:</u>³²</p> <ul style="list-style-type: none"> • Footnote 3 <p><u>ISA 600:</u></p> <ul style="list-style-type: none"> • Footnote 7 <p><u>ISA 610:</u></p> <ul style="list-style-type: none"> • Footnote 1 <p><u>ISA 700 (Revised):</u></p> <ul style="list-style-type: none"> • Footnote 35 <p><u>ISA 701:</u></p> <ul style="list-style-type: none"> • Footnote 5 <p><u>ISA 720 (Revised):</u></p> <ul style="list-style-type: none"> • Footnote 11 <p><u>ISA 800:</u></p> <ul style="list-style-type: none"> • Footnote 5
Relevant assertion (this is now a defined term)	<i>As appropriate</i>	<p>Refer to Appendix 1:</p> <ul style="list-style-type: none"> • ISA 265 para. A8
<i>Aspects of the entity's</i> information system (ISA 315 (Revised), para. 18)	Alignment to the requirements to understanding the information system. (ISA 315 (Revised), para. 18)	<u>ISA 402:</u> Para. 3 (refer to Appendix 1)

1. Proposed conforming amendments to detailed references to ISA 315 (Revised) in footnotes (of other ISAs):
 - (i) ISA 210, Para. A16, footnote 14:
 - ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, Appendix 3, proposed³³ paragraph ~~16A54~~
 - (ii) ISA 210, Para. A18, footnote 15:
 - ISA 315 (Revised), proposed paragraph ~~A67a59~~ and Appendix ~~34~~

³² ISA 570 (Revised), *Going Concern*

³³ The proposed paragraph(s) in this section refers to the paragraph numbers presented in Agenda Items 3-A and 3-B.

- (iii) ISA 265, Para 2, footnote 4:
 - ISA 315 (Revised), paragraph 12. Proposed paragraphs ~~A10068–A108c73~~ provide guidance on controls relevant to the audit
 - (iv) ISA 265, Para. A8, footnote 5:
 - ISA 315, proposed paragraph ~~A109a74~~
 - (v) ISA 320, Para. 6, footnote 3:
 - *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*, proposed paragraphs ~~A134–A135A127c~~.
 - (vi) ISA 550, Para. A7, footnote 18
 - ISA 315 (Revised), Appendix 1 proposed paragraphs ~~2A34–A35~~, provides guidance regarding the nature of a special-purpose entity.
 - (vii) ISA 610, Para. 7, footnote 3:
 - ISA 315 (Revised) proposed paragraph ~~A42089r~~
 - (viii) ISA 610, Para A26, footnote 25:
 - ISA 315 (Revised) proposed paragraph ~~A42089r~~
 - (ix) ISA 700 (Revised), Para. A47, footnote 35:
 - ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, proposed paragraph ~~4(e)(f)~~
2. Proposed conforming amendments where extant references to ISA 315 (Revised) no longer exist (i.e. deleted and not replaced):

ISA 260 para. A52:

As noted in paragraph 4, effective two-way communication assists both the auditor and those charged with governance. Further, ISA 315 (Revised) 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.³⁴ Inadequate two-way communication may indicate an unsatisfactory control environment and influence the auditor's assessment of the risks of material misstatement. There is also a risk that the auditor may not have obtained sufficient appropriate audit evidence to form an opinion on the financial statements.

Explanation:

Extant paragraph A78 of ISA 315 (Revised) has been moved to Appendix 3 of the standard and subsequently the wording of the elements of the control environment has been aligned with COSO 2013.³⁵ Through this process, the 'participation of those charged with governance' has been replaced

³⁴—ISA 315 (Revised), A78

³⁵ The Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Internal Control – Integrated Framework (2013)*

with 'how those charged with governance demonstrates independence from management and exercise oversight of the entity's system of internal control.' Accordingly, the extant reference in ISA 260, paragraph A52 no longer applies.

Description of components of the system of internal control

1. ISA 210, para. 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.³⁶ 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.

Controls within the entity’s process to monitor the system of internal control

2. ISA 600, Appendix 2, paragraph 1 (8th bullet)

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 within the group’s process to monitor ~~Monitoring the system of internal~~ controls, including activities of the internal audit function and self-assessment programs.

Control activities

3. ISA 265, para. 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~~.

‘Controls relevant to the audit’, and the ‘system internal control’

4. ISA 402, para. 10

When obtaining an understanding of the system of internal control relevant to the audit ~~financial reporting~~ in accordance with ISA 315 (Revised),³⁷ the user auditor shall evaluate the design and implementation of ~~relevant~~ controls relevant to the audit at the user entity that relate to the services

³⁶ ISA 315 (Revised), proposed paragraph ~~A67a~~⁵⁹ and Appendix 34

³⁷ ISA 315 (Revised), paragraph 12

provided by the service organization, including those that are applied to the transactions processed by the service organization. (Ref: Para. A12–A14)

Describing aspects of the entity and its environment in extant ISA 315 (Revised):

5. ISA 230, para. 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 320,³⁸ assessed risks, significant matters noted during the audit, and conclusions reached.

References to risks that 'require special audit consideration'

6. ISA 260 (Revised), para. 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.

7. ISA 550, para. A28

Sharing Related Party Information with the Engagement Team (Ref: Para. 17)

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.

8. ISA 600, para. A6

The group engagement team may also identify a component as likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances, ~~(that is, risks that require special audit consideration³⁹)~~. For example, a component could be responsible for foreign exchange trading and thus expose the group to a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group.

³⁸ ISA 320, *Materiality in Planning and Performing an Audit*

³⁹ ISA 315 (Revised), paragraphs 27–29

9. ISA 610, para. A21

As explained in ISA 315 (Revised),⁴⁰ ~~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 judgment. 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.

10. ISA 701, para. A20

ISA 315 (Revised) defines a significant risk as an identified ~~and assessed~~ risk of material misstatement:

- For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which one or a combination of the inherent risk factors affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should that misstatement occur; or
- That is to be treated as a significant risk in accordance with the requirement of other ISAs.⁴¹
~~that, in the auditor's judgment, requires special audit consideration. Areas of significant management judgment and significant unusual transactions may often be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention.~~

Extant references to relevant controls

11. ISA 530

Appendix 2, factor 1

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

12. ISA 550, para. A34

Depending upon the results of the auditor's risk assessment procedures, the auditor may consider it appropriate to obtain audit evidence without testing the entity's controls over related party relationships and transactions. In some circumstances, however, it may not be possible to obtain sufficient appropriate audit evidence from substantive audit procedures alone in relation to the risks of material misstatement associated with related party relationships and transactions. For example, where intra-group transactions between the entity and its components are numerous and a significant amount of information regarding these transactions is initiated, recorded, processed or reported electronically in an integrated system, the auditor may determine that it is not possible to design

⁴⁰ ISA 315 (Revised), paragraph 4(e)

⁴¹ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 27 and ISA 550, *Related Parties*, paragraph 18

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 330 requirement to obtain sufficient appropriate audit evidence as to the operating effectiveness of ~~relevant~~ controls,⁴² the auditor is required to test the entity's controls over the completeness and accuracy of the recording of the related party relationships and transactions.

Extant references to 'relevant assertion'

13. ISA 265, para. A8

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

Alignment to the requirements to understanding the information system

14. ISA 402, para. 3

Services provided by a service organization 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. Although most controls at the service organization are likely to relate to financial reporting, there may be other controls that may also be relevant to the audit, such as controls over the safeguarding of assets. A service organization'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 organization'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 and 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;~~

⁴² ISA 330, paragraph 8(b)

- ~~(d) How the user entity's information system captures events and conditions, other than transactions, that are significant to the financial statements;~~
- (ce) 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.~~

Describing aspects of the entity and its environment in extant ISA 315 (Revised):

1. ISA 550, para. A12

However, where the framework does not establish related party requirements, the entity may not have such information systems in place. Under such circumstances, it is possible that management may not be aware of the existence of all related parties. Nevertheless, the requirement to make the 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. 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 315 (Revised) to obtain information regarding the entity's organizational structure, ownership, governance and business model.⁴³

- ~~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.

2. ISA 600, para. A23

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

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

- The entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT;
- Relevant industry, regulatory, and other external factors that affect the entity;⁴³
- The relevant measurement used, internally and externally, to assess and review of the entity's financial performance; and
- The including the applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and.⁴³

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

3. ISA 720 (Revised), para. A31

The auditor's knowledge obtained in the audit includes the auditor's understanding of the entity and its environment, the applicable financial reporting framework, and including the entity's system of

⁴³ ISA 315 (Revised), proposed paragraphs A3125–A49k

internal control, obtained in accordance with ISA 315 (Revised).⁴⁴ ISA 315 (Revised) sets out the auditor's required understanding, which includes such matters as obtaining an understanding of:

- (a) The entity's organizational 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;
~~The nature of the entity;~~
~~The entity's selection and application of accounting policies;~~
~~The entity's objectives and strategies;~~
- (c) The relevant measures used, internally and externally, to assess measurement and review of the entity's financial performance;~~and~~
- (d) The applicable financial reporting framework; and
- (e) The entity's system of internal control.

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

4. Extant elements of the auditor's understanding of the 'entity and its environment' – ISA 315 (Revised) paragraph 11:

The Entity and Its Environment

The auditor shall obtain an understanding of the following:

- (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework. (Ref: Para. A25–A30)
- (b) The nature of the entity, including:
 - (i) its operations;
 - (ii) its ownership and governance structures;
 - (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
 - (iv) the way that the entity is structured and how it is financed, to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements. (Ref: Para. A31–A35)
- (c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry. (Ref: Para. A36)
- (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. (Ref: Para. A37–A43)
- (e) The measurement and review of the entity's financial performance. (Ref: Para. A44–A49)

⁴⁴ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraphs 11–12

5. Revised elements of the auditor's understanding of the 'entity and environment' – proposed ISA 315 (Revised) paragraph 11:

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

- (a) The entity and its environment, including:
 - (i) The entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT; (Ref: Para A31–A43)
 - (ii) Relevant industry, regulatory and other external factors; and (Ref: Para. A43a–A43f)
 - (iii) The relevant measures used, internally and externally, to assess the entity's financial performance. (Ref: Para. A44–A49a)
- (b) The applicable financial reporting framework, including: (Ref: Para.A49b–A49e)
 - (i) How it applies in the context of the nature and circumstances of the entity and its environment, including how events or conditions are subject to, or affected by, the inherent risk factors; and (Ref: Para.A49f–A49k)
 - (ii) The entity's accounting policies and any changes thereto, including the reasons for any changes to the entity's accounting policies.