Agenda Item 2-B

Working [Draft] Audit Standard

(December 2020)

*This working [draft] audit standard will not be discussed in detail at the December 2020 IAASB Board meeting except to the extent that related matters have been raised in the Issues Paper (see **Agenda Item 2**). However, time permitting, the Working Group Chair will ask for input on the content of each Part more broadly.*

*This [draft] audit standard has been developed based on the ISAs, however is presented in a different flow (i.e., not topic-based like the ISAs). Accordingly, to be able to trace how the requirements within this [draft] audit standard correspond to the ISA requirements, please see **Agenda Item 2-C and 2-D**.*

CONTENTS

3. Acceptance or Continuance of an Audit Engagement and Initial Engagements

4. Planning

5. Risk Identification and Assessment

6. Responding to Assessed Risks of Material Misstatement

7. Concluding

8. Forming an Opinion and Reporting

INTRODUCTION

Applicability[1]

This [draft] audit standard has been written in the context of an audit of the financial statements of a less complex entity. The auditor's procedures are designed for auditors in the private and public sector. If an entity does not meet the matters set out below, and an audit is required to obtain reasonable assurance, the International Standards on Auditing (ISAs) should be used.

This [draft] audit standard has been designed for audits of entities where the nature and circumstances of the entity and its financial reporting are such that the audit would be considered to be less complex, and:

(a) The entity being audited is [*not listed*], or

(b) Law or regulation does not restrict the use of this [draft] audit standard.

The requirements within this [draft] audit standard do not address specific considerations for [listed entities]. It also does not address complex matters or circumstances as described further below. Accordingly, using this [draft] audit standard in these circumstances may result in the inability of the auditor to obtain sufficient or appropriate evidence to be able to issue a reasonable assurance opinion.

If the audit will involve the use of internal auditors, or key audit matters and segment reporting information is voluntarily provided, this [draft] audit standard does not contain relevant requirements to address these matters.

Individual jurisdictions may also restrict use of this standard.

When is an Audit is Considered Less Complex

The auditor's view about the complexity of the audit is a professional judgment. This professional judgment, in the context of the entity being audited, will help the auditor determine whether this [draft] audit standard is appropriate for the nature and circumstances of the entity being audited, which will enable the auditor to gather sufficient appropriate audit evidence to support a reasonable assurance opinion.

Complexity in the audit arises from the nature or characteristics of the entity, in the application of the applicable financial reporting framework, or both. The following sets out matters that may help the auditor in determining whether the audit is considered less complex for the purpose of this [draft] audit standard, and therefore whether this [draft] audit standard is appropriate to use for the audit.

Nature or Characteristics of the Entity

If the entity being audited exhibits one or more of the following, this may in the auditor's professional judgment, indicate that this standard may not be appropriate to use:

- The entity's organizational structure is complex (i.e., there are many subsidiaries, divisions or other components, in multiple locations).
- The entity's consolidation process (if any) is not straightforward (e.g., the components may have different IT systems or may be located in different jurisdictions).

[1] Professional judgments made in deciding to use the [draft] audit standard are required to be documented in Part 4 of this [draft] audit standard.

- There are [numerous] component auditors involved in the audit.[2]
- The entity's business model gives rise to business risks that result in pervasive risks to the financial statements.
- The entity is highly regulated, for example the entity has prudential requirements that must be complied with.
- Oversight responsibilities do not rest with one, or very few, individuals.
- There are many individuals involved in roles related to financial reporting, including those involved in the initiation and processing of transactions, events and conditions.
- The entity's governance structure is multifaceted, and those charged with governance are separate and independent from those running the entity day to day.
- The entity has multiple or fully integrated IT systems, where there are extensive, complex controls over the flow of information and significant testing of controls and use of IT specialists is required.
- If the entity uses a service organization, the auditor does not have access to the relevant records and information at the service organization, or the auditor would not be able to obtain sufficient appropriate audit evidence with regard to the financial information received from the service organization in another way.

Application of the Applicable Financial Reporting Framework

It is unlikely that the audit would be considered less complex when preparing the financial statements is inherently more challenging due to the application of the applicable financial reporting requirements.

As the complexity of the financial reporting increases, so does the complexity of the procedures required to gather sufficient appropriate audit evidence. The following are examples of topics where the financial reporting requirements would likely be inherently more challenging to audit:

- Accounting and reporting of insurance contracts.
- Accounting and reporting by retirement benefit plans.
- Accounting and reporting by entities with mining activities where those activities include production activities.
- Recognition and measurement of complex financial instruments.
- Accounting and reporting with respect to emerging areas, such as cryptocurrencies.

Complexity in the audit may also increase when, in applying the requirements of the applicable financial reporting framework:

- There are many potential data sources with different characteristics.
- Processing of data involves many interrelated steps.
- Information or data is inherently difficult to identify, capture, access, understand or process.
- There are limitations in available knowledge and subjective judgments that need to be made to include information in the financial statements (e.g., there could be different approaches to how underlying

2 [Note for IAASB: As noted, the LCE Working Group is still deliberating how the work of component auditors in a group audit should be included within the [draft] audit standard, and therefore this aspect will change as further clarity on this is determined.]

information is prepared or significantly different outcomes could result from appropriately applying the requirements of the applicable financial reporting framework).

As the audit progresses, the auditor remains alert to changes in the matters set out above which may change the auditor's determination about whether this [draft] audit standard is appropriate for the audit.

Preparation of the Financial Statements

Law or regulation may establish the responsibilities of management, and where appropriate, those charged with governance, in relation to financial reporting. An audit in accordance with this [draft] audit standard is conducted on the premise that management (or where appropriate, those charged with governance) have acknowledged and understood that they have responsibility:

- For the preparation of the financial statements in accordance with the applicable financial reporting framework.
- To provide the auditor with access to all information of which they are aware that is relevant to the preparation of the financial statements, and persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Reasonable Assurance

As the basis for the auditor's opinion, this standard requires the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

Inherent Limitations of an Audit

There are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive in nature. The inherent limitations of an audit arise from:

- The nature of financial reporting frameworks;
- The nature of audit procedures; and
- The need for audits to be conducted within a reasonable time and at a reasonable cost.

There are also practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

- Not all relevant information may be provided to the auditor, either intentionally or unintentionally.
- Fraud may be occurring which is designed to conceal it, and audit procedures may therefore be ineffective.
- An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal authority, such as the powers of search, which may be necessary for such an investigation.

Format of this Standard

This [draft] audit standard has been presented in Parts, which follows the flow of an audit engagement.

- Part 1 sets out the fundamental concepts and overarching principles.
- Part 1A sets out the auditor's and engagement partner's obligations and responsibilities for quality management in an audit of a less complex entity.
- Part 2 sets out the general requirements relating to audit evidence, communication and documentation, as well as the overall objective of the audit. The concepts and principles within this part are to be applied throughout the audit.
- Parts 3 to [8] set out the detailed requirements for the audit. Each of these Parts includes specific communication and documentation requirements as necessary.

Authority

This [draft] audit standard includes the auditor's objectives in planning and performing the audit. This context is intended to assist the auditor to understand the procedures to be performed and audit evidence to be gathered.

This standard does not override local laws or regulations that govern audits of financial statements in a particular country.

The effective date for this [draft] audit standard is set out in Part 1 of this standard.

Each Part contains non-authoritative introductory material [in a box] that sets out the content for that Part. Each Part includes:

- Objective(s), which link the requirements and the overall objective of the audit.
- Requirements to be met, except where the requirement is conditional and the condition does not exist.

Requirements are expressed using "shall." Essential explanatory material is presented in italics and does not impose additional obligations on the auditor.

Application Material

[Note to IAASB: to be determined once agreed what/if application material will be within the [draft] audit standard]

Definitions

To assist in consistent application and interpretation of the requirements in this [draft] audit standard, the definitions contained in the IAASB's *Glossary of Terms* apply.

Non-Authoritative Material

The IAASB may issue Staff publications to support the implementation of this [draft] audit standard. Other implementation material to support application of this material has been issued by [XXX…. tbd].

Firm Quality Management

Systems of quality management, including the policies or procedures are the responsibility of the firm. International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits* *or Reviews for Financial Statements, or Other Assurance or Related Services Engagements* applies to all firms that perform audits. This [draft] audit standard is premised on the basis that the firm is subject to ISQM 1 or to national requirements that are at least as demanding.

If an engagement quality review is required by the policies or procedures that are in accordance with ISQM 1, ISQM 2, *Engagement Quality Reviews*, deals with the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review.

Ethical Requirements Relating to an Audit of Financial Statements

The auditor is subject to relevant ethical requirements, including those related to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the *International Code of Ethics for Professional Accountants, Including International Independence Standards* (Code of Ethics) related to an audit of financial statements together with national requirements that are more restrictive. This [draft] audit standard is premised on the basis that the auditor is complying with the Code of Ethics or to national requirements that are at least demanding.

1. Fundamental Concepts and General Principles

Part 1 sets out the:

- The effective date of the standard.
- Overall objectives of the auditor. Each Part within this standard contains an objective, which provides a link between the requirements within that Part and the overall objectives of the auditor.
- Fundamental concepts and general principles that apply throughout the audit of a less complex entity.

1.1. Effective Date

1.1.1. This standard is effective for audits of [financial statements / historical financial information] for periods beginning on or after [XXX].

1.2. Overall Objectives of the Auditor

1.2.1 The overall objectives of the auditor when conducting an audit of financial statements using this [draft] audit standard are to:

(a) Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, to enable the auditor to express an opinion on whether the financial statements are prepared, in all material respects in accordance with an applicable financial reporting framework; and

(b) Report on the financial statements, and communicate as required by the [draft] audit standard, in accordance with the auditor's findings.

1.2.2 To achieve the overall objectives, the auditor shall achieve the objectives in each Part of this [draft] audit standard. Because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated, the auditor shall determine whether procedures in addition to those required by this [draft] audit standard are required to achieve the objectives in each Part.

1.2.3 If the objective(s) of a particular part cannot be achieved, the auditor shall consider the effect on achieving the overall objective, for example the auditor may be required to:

(a) Modify the auditor's opinion; or

(b) Withdraw from the engagement.

1.3. Fundamental Concepts and General Principles for Performing the Audit

1.3.1 When an audit is performed in accordance with this [draft] audit standard, the auditor shall comply with all relevant requirements. A requirement is relevant when the circumstances addressed by the requirement exist.

1.3.2 The auditor shall not represent that an audit was performed in accordance with this standard unless all applicable requirements have been met.

1.3.3 The auditor shall have an understanding of the entire text of this standard to understand its objectives and apply its requirements properly.

1.3.4. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement. In such circumstances, the auditor shall perform alternative procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement.

Sufficient Appropriate Audit Evidence

1.3.5. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level at the financial statement and assertion level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.

1.3.6. *Sufficiency is the measure of the quantity of audit evidence, and is affected by the auditor's risks of material misstatement (the higher the assessed risks, the more evidence is likely to be required) and also the quality of the evidence (the higher the quality, the less may be required). Obtaining more evidence, however, may not compensate if it is of poor quality*.

1.3.7. *Appropriateness is the measure of the quality of the audit evidence, that is its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and dependent on the individual circumstances under which it is obtained*.

1.3.8. *Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment*.

Professional Skepticism

1.3.9. The auditor shall plan and perform the audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.

1.3.10. Professional skepticism involves performing procedures in a way that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that is contradictory.

1.3.11. *Professional skepticism is necessary to the critical assessment of audit evidence, and the auditor remains alert to, for example:*

- *Audit evidence that contradicts other audit evidence obtained.*
- *Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.*
- *Conditions that may indicate possible fraud.*
- *Circumstances that suggest the need for audit procedures in addition to those required by this standard.*

1.3.12. Throughout the audit the auditor shall recognize the possibility that a material misstatement because of fraud may exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance.

Professional Judgment

1.3.13. The auditor shall exercise professional judgment in planning and performing the audit.

1.3.14. *The exercise of professional judgment in any particular case is based on the facts and circumstances that are known to the auditor up to the date of the auditor's report, and decisions made by auditors whose training, knowledge and experience are appropriate to achieve reasonable professional judgments (i.e., the professional judgment reached reflects a competent application of auditing and accounting principles and is appropriate in the circumstances).*

1.3.15. *Professional judgment needs to be appropriately documented.*

1A. Engagement Quality Management

Part 1A sets out the responsibilities for managing and achieving quality in the audit engagement.

The firm is responsible for designing, implementing and operating a system of quality management for audits of financial statements, that provides the firm reasonable assurance that the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements, and that engagement reports issued are appropriate in the circumstances. The engagement team, led by the engagement partner, is responsible within the context of the firm's system of quality management for:

- Implementing the firm's responses to quality risks;
- Determining whether additional responses are needed; and
- Communicating as required.

1A.1. Objectives

1A.1.1. The objectives of the auditor are to manage audit quality at the engagement level such that:

(a) The auditor has conducted the audit in accordance with professional standards and the applicable legal and regulatory requirements; and

(b) The auditor's report is appropriate in the circumstances.

1A.2. The Engagement Partner's Responsibilities

1A.2.1 *The requirements relating to direction, supervision and review of the work of other members of the engagement team are only relevant if there are other members of the engagement team other than the engagement partner.*

1A.2.2 The engagement partner shall take overall responsibility for managing and achieving quality on the audit engagement. In doing so, the engagement partner shall be sufficiently and appropriately involved throughout the audit engagement to determine that the significant judgments made and conclusions reached are appropriate in the circumstances.

1A.2.3. If the engagement partner assigns the design or performance of procedures, tasks or actions to other members of the engagement team, the engagement partner shall continue to take overall responsibility for managing and achieving quality through direction and supervision of the other members of the engagement team, and review of their work. The nature, timing and extent of direction, supervision and review is responsive to the nature and circumstances of the engagement.

1A.2.4. Throughout the audit engagement, the engagement partner shall:

(a) Take responsibility for identifying, evaluating and addressing threats to compliance with relevant ethical requirements, including those related to independence that are applicable given the nature and circumstances of the engagement and the firm's policies and procedures; and

(b) Remain alert, through observation, inspection of audit documentation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team.

1A.2.5. The engagement partner shall take responsibility for:

(a) Determining that the firm's policies and procedures regarding acceptance and continuance of the audit engagement have been followed and determining that conclusions reached in this regard are appropriate;

(b) Consultations being made in accordance with the firm's policies and procedures on difficult or contentious matters, and determine that conclusions agreed have been implemented; and

(c) Differences of opinions within the engagement team, with those consulted and with the engagement partner and the engagement quality reviewer have been addressed and resolved, with conclusions reached documented and implemented, in accordance with the firm's policies and procedures.

1A.2.6. The engagement partner shall:

(a) Taking into account the nature and circumstances of the audit, determine whether:

    (i) Sufficient and appropriate resources are assigned to the engagement; and

    (ii) That members of the engagement team, and any experts, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement; and

    If the above conditions are not met, the engagement partner shall take appropriate action, including communicating with appropriate individuals about the need to assign or make available additional or alternative resources to the engagement.

(b) Review audit documentation at appropriate points in time during the audit, including documentation relating to significant matters, significant judgments (including those relating to difficult or contentious matters) and other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities;

(c) On or before the date of the auditor's report, determine that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued;

(d) Prior to dating the auditor's report, review the financial statements and the auditor's report to determine that the auditor's report being issued is appropriate in the circumstances;

(e) Determine whether the results of the firm's monitoring and remediation process and, if applicable, other network firms, and deficiencies noted in that information may affect the audit engagement; and

(f) Where an engagement quality review is required, determine that the engagement quality review has been performed in accordance with the firm's policies and procedures and completed before the date of the auditor's report.

If the audit is a group audit engagement, all of the above apply to the group audit.

2. Audit Evidence

Part 2 sets out the broad requirements to be applied throughout the audit for:

- *Audit evidence.*
- *Procedures for obtaining audit evidence, including sampling and substantive analytical procedures.*
- *Documentation.*
- *Communication with management and those charged with governance.*

This Part sets out the overarching documentation and communication requirements for all Parts. Within individual Parts there may be additional specific documentation and communication requirements.

2.1. Objectives

2.1.1. The objectives of the auditor are to:

(a) Obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion;

(b) Prepare documentation that provides a sufficient and appropriate record of the basis for the auditor's opinion and provides evidence that the audit was planned and performed in accordance with this [draft] audit standard and applicable laws and regulations; and

(c) Communicate clearly about matters related to the audit, obtain information relevant to the audit, provide timely observations that are relevant to management (or those charged with governance) and, where appropriate, promote effective two-way communication between the auditor and those charged with governance.

2.2. Audit Evidence

2.2.1 *Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is obtained from audit procedures performed during the audit*.

2.2.2 The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

2.2.3 *Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry. Inquiry alone does not ordinarily provide sufficient audit evidence*.

Information to be Used as Audit Evidence

2.2.4 When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.

2.2.5 *Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. The relevance of the information may be affected by the direction of testing*.

2.2.6 *The reliability of information to be used as audit evidence is influenced by its source and nature, as well as the circumstances under which it was obtained. Generally, the reliability of information is increased when it is obtained from a source outside of the entity, original is more reliable than a copy* *and written is more reliable than oral information. However, circumstances may exist that could affect these generalizations*.

2.2.7 When using information produced by the entity, the auditor shall evaluate:

(a) Whether the information is sufficiently reliable for the auditor's purposes;

(b) The accuracy and completeness of the information; and

(c) Whether the information is sufficiently precise and detailed for the auditor's purposes.

2.2.8 The auditor may accept records and documents as genuine unless there is reason to believe otherwise, in which case the auditor shall investigate any inconsistencies. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further and determine the effect on the rest of the audit evidence obtained.

2.2.9 The auditor shall determine what modifications or additions to audit procedures are necessary if:

(a) Audit evidence obtained from one source is inconsistent with that obtained from another; or

(b) The auditor has doubts about the reliability of information to be used as audit evidence.

Using Audit Evidence Obtained During an Interim Period

2.2.10. If the auditor obtains audit evidence about the operating effectiveness of controls in an interim period, the auditor shall obtain evidence about significant changes to those controls subsequent to the interim period and determine additional evidence to be obtained for the remaining period.

2.2.11. If substantive procedures are performed at an interim date, the auditor shall cover the remaining period by performing:

(a) Substantive procedures, combined with tests of controls for the intervening period; or

(b) If the auditor determines that it is sufficient, further substantive procedures only,

that provide a reasonable basis for extending the audit conclusions from the interim date to the period end.

2.3. Procedures for Obtaining Audit Evidence

2.3.1. *Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing procedures to identify and assess risks of material misstatement (see Part 5) and further audit procedures (comprising test of controls and substantive procedures) (see Part 6). Tests of controls are only required in specific circumstances (see paragraph XX) or the auditor may choose to perform tests of controls. Substantive procedures include tests of detail and substantive analytical procedures*.

2.3.2. When designing tests of controls and tests of details, the auditor shall determine the means of selecting items to test that are effective in meeting the purpose of the audit procedure.

Substantive Analytical Procedures

2.3.3. When the auditor uses substantive analytical procedures for the purpose of obtaining audit evidence (either in risk identification or in responding to assessed risks), the auditor shall:

(a) Determine the suitability of substantive analytical procedures for the purpose of the test or for the given assertion;

(b) Evaluate the reliability of data used in the analyses;

(c) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify misstatements;

(d) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation being required; For identified differences exceeding acceptable levels, use professional judgment when investigating such differences and perform additional audit procedures as necessary in the circumstances; and

(e) Evaluate whether unusual or unexpected relationships that have been identified, including those related to revenue accounts, may indicate risks of material misstatement due to fraud.

Audit Sampling

2.3.4. If the auditor uses audit sampling when responding to assessed risks of material misstatement as a means for selecting items to test, the auditor shall:

(a) Consider the purpose of the audit procedures and the characteristics of the population from which the sample will be drawn.

(b) Determine the sample size is sufficient to reduce the risk of sampling error to an acceptably low level.

(c) Select items in a way that each sampling unit in the population has a chance of selection.

(d) Perform audit procedures, appropriate to the purpose, on each item selected, unless it is not applicable to the selected item. If the auditor is unable to apply the procedure to the selected item, unless it is not applicable that item will be treated as a deviation.

(e) Investigate misstatements identified in the sample as to their nature and cause, and consider their effect on the audit procedure and other areas of the audit. For tests of detail, excluding misstatements that do not affect the remaining population, the auditor shall project misstatements found in the sample to the whole population.

External Confirmations

2.3.5. The auditor shall consider whether external confirmation procedures are to be performed as substantive procedures.

2.3.6. *External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions.*

2.4. Fraud

2.4.1. *The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. Although fraud is a broad legal concept, for the purposes* *of this [draft] audit standard, the auditor is concerned with fraud that causes a material misstatement in the financial statements*.

2.4.2. *An auditor conducting an audit in accordance with this [draft] audit standard is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor.*

2.4.3. *When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this [draft] audit standard are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.*

2.4.4. The auditor shall include specific considerations with regard to fraud when:

(a) Identifying and assessing risks of material misstatement. In doing so, the auditor shall evaluate whether information obtained from the procedures to identify and assess risks and related activities indicates that one or more fraud risk factors are present;[3]

(b) Obtaining sufficient appropriate audit evidence through designing and implementing appropriate responses to assessed risks of material misstatement; and

(c) Responding appropriately to fraud or suspected fraud identified during the audit.

Auditor Unable to Continue the Engagement

2.4.5. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstance that bring into question the auditor's ability to continue performing the audit, the auditor shall determine the legal and professional responsibilities applicable in the circumstances.

2.5. Laws and Regulations

2.5.1 *It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.*

2.5.2. *The requirements in this standard are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with laws and regulations. This standard distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations as follows:*

[3] Appendix X sets out fraud risk factors relevant to less complex entities.

(a) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements (e.g., tax and pension laws and regulations); and

(b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (e.g., compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations), i.e., non-compliance with such laws and regulations may therefore have a material effect on the financial statements

2.5.3. During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention.

2.5.4. In the absence of identified or suspected non-compliance, the auditor is not required to perform audit procedures regarding the entity's compliance with laws and regulations, other than what is required by this standard.

2.6. Remaining Alert for Related Party Information

2.6.1. During the audit, the auditor shall remain alert, when inspecting records or documents, for:

(a) The entity's related parties, including circumstances relating to the existence of a related party with dominant influence; and

(b) Arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, and significant transactions outside the entity's normal course of business.

2.7. Overarching Documentation Requirements

2.7.1 Specific matters to be documented are set out throughout this [draft] audit standard. The auditor shall prepare audit documentation on a timely basis that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

(a) The nature, timing and extent of the audit procedures performed in accordance with this standard and applicable legal and regulatory requirements, including recording:

(i) The identifying characteristics of the specific items or matters tested;

(ii) Who performed the work and the date such work was completed;

(iii) Who reviewed the audit work performed and the date and extent of such review, including what was reviewed;

(b) The results of the audit procedures performed, and the audit evidence obtained; and

(c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

2.7.2. *The significance of a matter requires professional judgment and the analysis of the facts and circumstances, and may include matters giving rise to significant risks, areas where the financial* *statements could be materially misstated, circumstances where the auditor has had difficulty in applying the necessary audit procedures, or any findings that could result in a modified audit opinion*.

2.7.3 *The form, content and extent of audit documentation depends on many factors related to the nature and circumstances of the entity and the procedures being performed. Audit documentation may be in paper or electronic format. It is not necessary to include superseded drafts of working papers or financial statements in the audit documentation. Oral explanations, by the auditor on their own, do not adequately support the work performed by the auditor or the conclusions reached.*

2.7.4 If the auditor identified information that is inconsistent with the auditor's conclusion regarding a significant matter, the auditor shall document how the inconsistency was addressed.

2.7.5 If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement of this standard, the auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure.

2.7.6. The auditor shall include in the audit documentation any:

(a) Communications about fraud made to management, those charged with governance, regulators and others; and

(b) Discussions of significant matters related to non-compliance with laws and regulations with management, those charged with governance and others, including how the matter has been responded to.

2.8. Overarching Communications with Management and Those Charged with Governance

2.8.1. *Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. Governance is the collective responsibility of a governing body, such as a board of directors, a supervisory board, partners, proprietors, a committee of management, a council of governors, trustees or equivalent. However, in many less complex entities, one person may be charged with governance, for example the owner-manager. Where those charged with governance are involved in managing the entity, the application of the communication requirements is adjusted to recognize this*.

2.8.2. *There may be other cases where it is not clear with whom to communicate, for example in some family owned businesses, some not-for-profit organizations and some government entities. In such cases the auditor may need to discuss and agree with whom communications should be made*.

2.8.3 The auditor shall communicate with those charged with governance on a timely basis.

2.8.4. *The appropriate timing for communications will vary with the circumstances of the audit, and may be affected by the significance and nature of the matter, and the actions expected to be taken by those charged with governance*.

2.8.5 Specific matters to be communicated are required throughout this [draft] audit standard. The auditor shall use professional judgment in determining the appropriate form, timing and general content of the communications with management (or those charged with governance). When determining the form of communication, the auditor shall consider:

(a) Legal requirements for communication; and

(b) The significance of the matters to be communicated.

2.8.6 The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

2.8.7 Where responses to inquiries of management and those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.

2.8.8 Where this standard requires matters to be communicated with management, and those charged with governance, the auditor shall document these matters, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation. Written communications need not include all matters that arose during the audit.

2.8.9. If the auditor has identified fraud or has obtained information that indicates that fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.

2.8.10. Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving:

(a) Management;

(b) Employees who have significant roles in internal control; or

(c) Others where the fraud results in a material misstatement in the financial statements,

the auditor shall communicate these matters to those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor shall communicate these suspicions to those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit.

2.8.11. Unless all of those charged with governance are involved in managing the entity, the auditor shall communicate, unless prohibited by law and regulation, matters involving non-compliance with laws and regulations that come to the auditor's attention during the course of the audit, other than those that are clearly inconsequential. If the matter is intentional and material, this communication shall be made as soon as is practicable.

3. Acceptance or Continuance of an Audit Engagement and Initial Engagements

ISQM 1 requires the firm to establish quality objectives that address the acceptance and continuance of client relationships and specific engagements.

Part 3 deals with the auditor's responsibilities for agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit are present.

Audit engagements may only be accepted when the auditor considers that relevant ethical requirements such as independence and professional competence and due care will be satisfied. In addition, the auditor considers the performance of non-assurance services for the audit client and whether this is permissible.

Performing acceptance or continuance procedures before planning commences assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the current engagement.

Part 3 also addresses activities related to initial engagements.

3.1 Objectives

3.1.1 The objectives of the auditor are:

(a) To accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

(i) Establishing whether the preconditions for an audit are present; and

(ii) Confirming that there is a common understanding between the auditor and management and, where appropriate those charged with governance, of the terms of the audit engagement.

(b) For initial engagements, to obtain sufficient appropriate audit evidence about whether:

(i) Opening balances contain misstatements that materially affect the current period's financial statements, and

(ii) The entity's accounting policies are appropriately reflected in the opening balances.

3.2 Preconditions for an Audit

3.2.1 In order to establish whether the preconditions for an audit are present, the auditor shall:

(a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable;

(b) Obtain the agreement of management that it acknowledges and understands its responsibility:

(i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;

(ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(iii) To provide the auditor with:

- Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
- Additional information that the auditor may request from management for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

3.2.2 If management or those charged with governance impose a limitation on the scope of the auditor's work such that the auditor believes that the limitation will result in the auditor disclaiming the opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

3.2.3 If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement:

(a) If there are any threats to compliance with relevant ethical requirements (that have not been addressed by appropriate safeguards), including independence;

(b) If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable; or

(c) If the agreement of management that it acknowledges and understands its responsibility has not been obtained.

3.3 Terms of the Audit Engagement

3.3.1. The auditor shall agree the terms of the audit engagement, in writing, with management or those charged with governance, as appropriate. In doing so, the auditor shall communicate the auditor's responsibilities for forming and expressing an opinion on the financial statements prepared by management, and that the auditor's responsibilities do not relieve management or those charged with governance from their responsibilities for preparing the financial statements. If the audit is of group financial statements, the terms of engagement are for the audit of the group financial statements.

3.3.2 On recurring engagements, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the engaging party of the existing terms of engagements.

3.3.3 The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so.

3.3.4 If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.

3.3.5 If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

3.3.6 If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

(a) Withdraw from the audit engagement where possible under applicable law or regulation; and

(b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

3.4 Initial Engagements

3.4.1. *The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements.*

3.4.2. If the engagement is an initial audit and there has been a change in auditors, the auditor shall communicate with the predecessor auditor.

3.4.3.The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that may materially affect the current period's financial statements by:

(a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;

(b) Determining whether the opening balances reflect the application of appropriate accounting policies; and

(c) Performing one or more of the following:

(i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;

(ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or

(iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

3.4.4. If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements.

3.4.5. The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and that any changes in accounting policies have been appropriately accounted for and adequately disclosed.

3.5 Specific Documentation Requirements

3.5.1 In addition to the general documentation requirements (paragraphs 2.7.1.–2.7.6.) for an audit engagement, the auditor shall include in the audit documentation matters identified, relevant discussions with personnel, and conclusions reached with respect to:

(a) Fulfillment of responsibilities relating to relevant ethical requirements, including applicable independence requirements.

(b) The acceptance and continuance of the client relationships and audit engagement.

3.5.2 The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

(a) The objective and scope of the audit of the financial statements;

(b) The responsibilities of the auditor;

(c) The responsibilities of management;

(d) Identification of the applicable financial reporting framework for the preparation of the financial statements;

(e) Reference to the expected form and content of any reports to be issued by the auditor; and

(f) A statement that there may be circumstances in which a report may differ from its expected form and content.

3.5.3 If law or regulation prescribes in sufficient detail the terms of the audit engagement referred to in this standard, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.

4. Planning

Part 4 deals with the auditor's responsibility to plan the audit (including holding an engagement team discussion), and materiality when planning and performing the audit.

The nature and extent of planning activities will vary according to the complexity of the entity, the size and nature of the engagement team, the engagement team members' previous experience with the entity and any changes in circumstances that occur during the audit engagement. When an engagement is carried out by a single individual some of the requirements may not be relevant (e.g., the engagement team discussion), however consideration may still be given to the matters within the relevant paragraphs as they may still assist the auditor.

Planning is not a discrete phase of the audit but is iterative, as necessary, throughout the audit. Some requirements within this Part are linked to procedures in other Parts of this [draft] audit standard and may require the auditor to execute on those procedures in order to meet the requirements in this Part.

When performing procedures to plan the audit, the auditor remains mindful of the applicability of the [draft] audit standard. If the auditor becomes aware of facts and circumstances that differ from those originally considered in determining applicability, the auditor may consider the ongoing use of the [draft] audit standard. In such cases, use of the (International Standards on Auditing (ISAs) may be more appropriate for the audit.

4.1. Objectives

4.1.1. The objectives of the auditor are to:

(a) Plan the audit so that it will be performed in an effective manner; and

(b) Determine materiality so that the concept of materiality can be used appropriately in planning and performing the audit.

4.2. Planning Activities

4.2.1. The engagement partner and other key members of the engagement team shall be involved in planning the audit.

4.2.2. The auditor shall evaluate compliance with relevant ethical requirements, including independence. In doing so, the engagement partner shall evaluate any threats through compliance with the firm's policies or procedures using relevant information from the firm, the engagement team or other resources, and take appropriate action.

4.2.3. The auditor shall set the scope, timing and direction of the audit. If the audit is a group audit, the scope, timing and direction shall include all components in the group. In establishing the scope, timing and direction of the audit, the auditor shall:

(a) Identify the characteristics of the engagement that define its scope;

(b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;

(c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;

(d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for this entity is relevant;

(e) Ascertain the nature, timing and extent of resources necessary to perform the audit, including determining whether experts are needed; and

(f) Plan the nature, timing and extent of direction and supervision of engagement members and review of their work.

4.2.4 If information to be used as audit evidence has been prepared using the work of management's expert, the auditor shall, to the extent necessary, have regard to the significance of the expert's work and evaluate the competence capabilities and objectivity of that expert, and evaluate the appropriateness of the expert's work as audit evidence for the relevant assertion.

4.2.5 The auditor shall update and change the scope, timing and direction as necessary during the audit.

4.2.6 The engagement partner shall take into account information obtained in the acceptance and continuance process in planning and performing the audit.

4.2.7 When information has been obtained from the previous experience with the client, or prior audits, the auditor shall evaluate whether such information remains relevant and reliable.

Engagement Team Discussion

4.2.8 The engagement partner and other key engagement team members shall:

(a) Discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement.

(b) Discuss fraud to identify possible areas where risks of material misstatement could arise. In doing so, the engagement team discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur, as well as how fraud or error could arise from related party relationships or transactions.

Any discussions among the engagement team shall occur setting aside beliefs the engagement team may have that management and those charged with governance are honest and have integrity.

4.2.9. *The engagement team discussion may also include other matters related to the audit such as the logistics, operational and other matters (such as where risks of material misstatement may have changed from prior years or matters related to relevant ethical requirement including independence) and the timing of the audit and communications that are required*.

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

Determining Whether to Use the Work of an Auditor's Expert

4.2.11. *This section deals with whether there is a need for the work of an individual or organization in a field of expertise other than accounting or auditing, which can then be used to assist the auditor in obtaining sufficient appropriate audit evidence. The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. Nonetheless, if the auditor using the work of an auditor's expert concludes that the work of* *that expert is adequate for the auditor's purposes, the auditor may accept that expert's findings or conclusions in the expert's field as appropriate audit evidence.*

4.2.12. If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert.

4.2.13. *If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required to be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the audit engagement. Further, the auditor is required to ascertain the nature, timing and extent of resources necessary to perform the engagement. The auditor's determination of whether to use the work of an auditor's expert, and if so when and to what extent, assists the auditor in meeting these requirements. As the audit progresses, or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's expert*.

4.2.14. The auditor shall consider the following when determining the nature, timing and extent of procedures related to the auditor's expert:

(a) The nature of the matter to which that expert's work relates;

(b) The risks of material misstatement in the matter to which that expert's work relates;

(c) The significance of that expert's work in the context of the audit;

(d) The auditor's knowledge of and experience with previous work performed by that expert; and

(e) Whether that expert is subject to the auditor's firm's quality control policies and procedures.

4.2.15. If the auditor is using the work of an auditor's expert, the auditor shall:

(a) Evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purpose;

(b) Obtain sufficient understanding of the field of expertise to enable the auditor to determine the nature, scope and objectives of the auditor's expert work; and

(c) Agree in writing with the auditor's expert the nature, scope and objectives of the expert's work, the role of the expert and the auditor's responsibilities in relation to that work, the nature, timing and extent of communications and whether there is a need for confidentiality.

Going Concern

4.2.16. The auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and:

(a) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or

(b) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

4.2.17. *Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.*

4.3. Materiality

4.3.1. *The concept of materiality is applied by the auditor in both planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements if any, on the financial statements and in forming an opinion in the auditor's report*.

4.3.2. The auditor shall determine materiality for the financial statements as a whole. If the audit is an audit of group financial statements, materiality is determined for the group financial statements.

4.3.3. *The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial needs of users of the financial statements. The auditor's professional judgment about misstatements that will be considered material provides a basis for:*

- *Determining the nature, timing and extent of procedures to identify and assess risks of material misstatement;*
- *Identifying and assessing the risks of material misstatement; and*
- *Determining the nature, timing and extent of further audit procedures.*

4.3.4. If, in the specific circumstances of the entity, there is 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, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

4.3.5. The auditor shall determine performance materiality for the purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.

4.3.6. If the auditor becomes aware of information during the audit that would have caused the auditor to determine a different materiality level or levels for particular classes of transactions, account balances or disclosures, the materiality level shall be revised. If this level is lower than what was initially determined, the auditor shall determine whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

4.4. Specific Communication Requirements

4.4.1. The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor.

4.5. Specific Documentation Requirements

4.5.1. In addition to the general documentation requirements (paragraphs 2.7.1–2.7.6) for an audit engagement, the auditor shall include the scope, timing and direction of the audit, and significant changes made during the audit, together with the reasons for such changes, in the audit documentation.

4.5.2. The auditor shall document the specific decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud.

4.5.3. With regard to materiality, the auditor shall include the following amounts and the factors considered in their determination in the audit documentation (including any revisions as applicable):

(a) Materiality for the financial statements as a whole;

(b) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures; and

(c) Performance materiality.

4.5.4. The auditor shall document the professional judgments made in determining that this [draft] audit standard is appropriate for the nature and circumstances of the entity being audited. The auditor shall also document changes if further information comes to the auditor's attention during the audit that may change the professional judgments made.

5. Risk Identification and Assessment

Part 5 deals with the auditor's responsibility to perform procedures to:

- Obtain an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control;
- Identify risks of material misstatement at the financial statement and assertion levels, whether due to fraud or error; and
- Assess inherent risk and control risk.

The auditor's risk identification and assessment process is iterative and dynamic. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control are interdependent with concepts within the requirements to identify and assess the risks of material misstatement.

The auditor uses professional judgment to determine the nature and extent of the procedures to be performed to meet the requirements of this standard, which will vary with the formality of the entity's policies and procedures. Some less complex entities, and particularly owner-managed entities, may not have established structured processes and systems (e.g., a risk assessment process or a process to monitor the system of internal control) or may have established processes or systems with limited documentation or a lack of consistency in how they are undertaken. When such systems and processes lack formality, the auditor may still be able to perform risk assessment procedures through observation and inquiry. However, the procedures within this standard are still required to be done.

If the audit is an audit of group financial statements, procedures performed, the understanding obtained, and risk identification and assessment, is in respect of the group financial statements.

When performing procedures to plan the audit, the auditor remains mindful of the applicability of the [draft] audit standard. If the auditor becomes aware of facts and circumstances that differ from those originally considered in determining applicability, the auditor may consider the ongoing use of the [draft] audit standard. In such cases, use of the ISAs may be more appropriate for the audit.

5.1 Objectives

5.1.1. The objectives of the auditor are to:

(a) Understand the entity and its environment, the applicable financial reporting framework and the entity's system of internal control to enable the auditor to identify and assess the risks of material misstatement; and

(b) Identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

5.2 Procedures for Identifying and Assessing Risks and Related Activities

5.2.1. The auditor shall design and perform procedures to obtain audit evidence that provides an appropriate basis for:

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

(b) The design of further audit procedures.

5.2.2. The procedures to identify and assess risks shall include:

(a) Inquiries with management, and other appropriate individuals within the entity; and

(b) Analytical procedures, including those to identify unusual or unexpected trends and relationships that may indicate risks of material misstatement. If unusual or unexpected trends and relationships are identified they shall be considered for fraud or error; and

(c) Observation and inspection.

5.2.3. In performing procedures to identify and assess the risks of material misstatement, the auditor shall also focus on possible risks of material misstatement arising from:

(a) Potential incentives or pressure to commit fraud, perceived opportunities to do so and rationalization of the act.

(b) Matters that may result in unrecognized liabilities, future commitments, or changes to current asset valuations.

(c) Whether transactions, events or conditions exist that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements.

(d) Events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

(e) Non-compliance with laws and regulations that may have a material effect on the financial statements.

Fraud

5.2.4. The auditor shall consider information, including information about fraud, from the acceptance and continuance procedures, and other engagements performed by the engagement partner for the entity in identifying risks of material misstatement arising from fraud.

5.2.5. Unless all of those charged with governance are involved in managing the entity, the auditor shall obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the controls that management has established to mitigate these risks.

5.2.6. The auditor shall consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud.

5.3. Understanding Relevant Aspects of the Entity

5.3.1. *The auditor's understanding of the entity and its environment, and applicable financial reporting framework, establishes a frame of reference in which the auditor identifies and assess the risks of material misstatement, and also informs how the auditor plans and performs further audit procedures. The auditor's understanding of the entity's system of internal control influences the auditor's identification and assessment of the risks of material misstatement, and also assists the auditor in planning and designing further audit procedures. The entity's system of internal control consists of the five components of internal control, for which an understanding is required for each:*

- *The control environment.*

- *The entity's risk assessment process.*
- *The entity's process to monitor the system of internal control.*
- *The information system and communications.*
- *Control activities.*

5.3.2. In obtaining an understanding of the entity and its environment and the applicable financial reporting framework, the auditor shall understand how inherent risk factors affect the susceptibility of assertions to misstatement, and the degree to which they do so.

5.3.3. For the entity's accounting estimates, the auditor shall take into account the degree to which the accounting estimate is subject to estimation uncertainty, and the degree to which the method, assumptions and data are affected by complexity and subjectivity.

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

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

Understanding the Entity and Its Environment

5.3.5. The auditor shall obtain an understanding of:

(a) The entity's organizational structure (including, if applicable, the group structure and components), ownership and governance, business model (including how the entity uses IT in its business model).

(b) The industry and other external factors.

(c) How the entity's financial performance is measured.

(d) The legal and regulatory framework applicable to the entity, and how the entity is complying with that framework.

(e) The entity's transactions and other events and conditions that may give rise to accounting estimates. When an estimate is assessed to be significant for an item in the financial statements, the auditor shall obtain an understanding of the assumptions and methods used in determining the estimate.

(f) Agreements or relationships that may result in unrecognized liabilities, future commitments or changes to current asset valuations through reviewing minutes of meetings and correspondence with legal counsel and reviewing legal expense accounts.

Understanding the Applicable Financial Reporting Framework

5.3.6. The auditor shall obtain an understanding of:

(a) The applicable financial reporting framework. In relation to accounting estimates, the understanding includes the recognition criteria, measurement bases, and the related presentation and disclosure requirements and how these apply in the context of the nature and circumstances of the entity and its environment.

(b) The entity's accounting policies and reasons for any changes thereto.

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

Understanding the Entity's System of Internal Control

5.3.8. *In less complex entities, and in particular owner-manager entities, the way in which the entity's system of internal control is designed, implemented and maintained will vary with the entity's size and complexity. Where there are no formal processes or documented policies or procedures, the auditor is still required to obtain an understanding of how management or those charged with governance prevent and detect fraud and errors, and use professional judgment to determine the nature of the work to obtain the required understanding*.

5.3.9. The auditor shall obtain an understanding of the entity's control environment, including:

(a) How management's oversight responsibilities are carried out; and

(b) How owner-managers have an active involvement and influence the risks arising from management override of controls due to lack of segregation of duties.

5.3.10. *The control environment includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's system of internal control an its importance in the entity*.

5.3.11. The auditor shall obtain an understanding of the entity's risk assessment process relevant to the financial statements, including how this process identifies and addresses risks related to accounting estimates.

5.3.12. *The entity's risk assessment process identifies business risks relevant to the preparation of the financial statements, and actions to address those risks.*

5.3.13. The auditor shall obtain an understanding of the entity's process to monitor the system of internal control, including how deficiencies are remediated.

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

5.3.15. The auditor shall consider the appropriateness of the control environment, the entity's risk assessment process and the entity's system of internal control in context of the nature and circumstances of the entity, and identify whether any control deficiencies exist.

5.3.16. The auditor shall obtain an understanding of the information system relevant to the preparation of the financial statements, including:

(a) For classes of transactions, account balances and disclosures, including how those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements:

(i) How the information system captures, processes and discloses events and conditions, other than transactions;

(ii) The accounting and other support records relating to the flows of information;

(iii) The entity's resources used in the financial reporting process;

(iv) The IT environment;

(b) The financial reporting process used to prepare the entity's financial statements, including disclosures; and

(c) For accounting estimates, how the accounting estimates are made, the models used, the source of data, the selection of assumptions and how management reviews the outcomes of previous estimates and responds to the results of that review.

In doing so, the auditor shall evaluate whether the entity's information system appropriately supports the preparation of the entity's financial statements in accordance with the applicable financial reporting framework.

5.3.17. The auditor shall obtain an understanding of how the entity communicates significant matters related to the preparation of the financial statements, and related reporting responsibilities, between people within the entity, between management and those charged with governance (if applicable) and with external parties (such as regulatory authorities).

5.3.18. The auditor shall obtain an understanding of controls that address risks of material misstatement at the assertion level as follows:

(a) Controls that address risks determined to be significant risks;

(b) Controls over journal entries including to record non-recurring unusual transactions or adjustments;

(c) Controls for which the auditor plans to test the operating effectiveness of controls, including those controls where substantive procedures alone are not enough to obtain sufficient appropriate audit evidence;

(d) Other controls, based on the auditor's professional judgment, where the auditor considers it appropriate to meet the objectives of identifying risks of material misstatement at the assertion level;

(e) If applicable, controls that relate to information processed by a service organization; and

(f) Controls, if any, established in relation to related party relationships to identify, account for, and disclose in accordance with the applicable financial reporting framework, authorize and approve significant transactions and relationships, and authorize and approve significant transactions and arrangements outside the normal course of business.

For each control identified in (a)–(f) above, the auditor shall evaluate whether the control is designed effectively, and determine whether the control has been implemented, by performing procedures more than inquiry.

5.3.19. *The auditor's identification and evaluation of controls is focused on information processing controls, which are controls applied during the processing of information in the entity's information system that directly address risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information). Controls are required to be identified when such controls meet one or more of the criteria included in paragraph 5.3.18. However, when multiple controls each achieve the same objective, it is unnecessary to identify each of the controls related to such objective.*

5.3.20. For the controls identified in paragraph 5.3.18 above, the auditor shall identify the IT applications and other aspects of the IT environment that are subject to risks arising from IT, and identify the related risks arising from the use of IT. For those risks arising from the use of IT identified, the auditor shall identify the entity's general IT controls, and evaluate whether the general IT control is designed effectively and determine whether the control has been implemented by performing procedures more than inquiry.

5.3.21. *The auditor's understanding of the information system (which may be done by performing a walkthrough test) includes the IT environment relevant to the flows of transactions and processing of information in the entity's information system, because the entity's use of IT applications or other aspects of the IT environment may give rise to risks arising from IT (i.e., the susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of information).*

5.3.22. *Identifying the IT applications that are subject to risks arising from the use of IT involves taking into account controls identified by the auditor because such controls may involve the use of IT or rely on IT. The auditor may focus on whether an IT application includes automated controls that management is relying on and that the auditor has identified, including controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. The auditor may also consider how information is stored and processed in the information system relating to significant classes of transactions, account balances and disclosures and whether management is relying on general IT controls to maintain the integrity of that information. The extent of the auditor's understanding of the IT processes, including the extent to which the entity has general IT controls in place, will vary with the nature and the circumstances of the entity and its IT environment, as well as based on the nature and extent of controls identified by the auditor. The number of IT applications that are subject to risks arising from the use of IT also will vary based on these factors*.

5.3.23. If the audit is an audit of group financial statements, the auditor shall obtain an understanding of the consolidation process, including the entity's instructions issued to components for the purpose of the consolidation process.

5.3.24. If the entity uses the services of a service organization, the auditor shall obtain an understanding of:

(a) The nature of the services provided by the service organization and the significance of those services to the entity;

(b) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization;

(c) The relevant contractual terms for the activities undertaken by the service organization;

(d) Controls at the service organization relevant to the entity's transactions; and

(e) The controls applied to transactions with the service organization.

Deficiencies in the System of Internal Control

5.3.25. The auditor shall determine whether, on the basis of the audit work performed in obtaining an understanding of the entity's system of internal control, the auditor has identified one or more deficiencies in the entity's system of internal control. If one or more deficiencies in the entity's system of internal control has been identified, the auditor shall determine whether, individually or in combination, they constitute significant deficiencies.

5.4. Identifying Risks of Material Misstatement

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

5.4.2. The auditor shall identify the risks of material misstatement, due to fraud or error, at:

(a) The financial statement level; and

(b) The assertion level for classes of transactions, account balances, and disclosures.

5.4.3. *Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole, and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance or disclosure level (e.g., risk of management override of controls). Appendix X sets out assertions that may be used by the auditor in considering different types of misstatements at the assertion level.*

5.4.4. In identifying the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

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

5.4.6. The auditor shall determine the relevant assertions and the related significant classes of transactions, account balances and disclosures.

5.4.7. *A relevant assertion is an assertion about a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement. The determination of whether an assertion is a relevant assertion is made before consideration of any related controls (i.e., the inherent risk). A significant class of transactions, account balance or disclosure is a class of transactions, account balance or disclosure for which there is one or more relevant assertions. In identifying and assessing the risks of material misstatement, the auditor uses assertions to consider the different types of potential misstatements that may occur. Assertions for which the auditor has identified related risks of material misstatement are relevant assertions.*

5.4.8. *Determining relevant assertions and the significant classes of transactions, account balances and disclosures provides the basis for the scope of the auditor's understanding of the entity's information system required to be obtained, and with the identification and assessment of risks of material misstatement.*

5.5 Risk Assessment

Assessing Inherent Risk

5.5.1. For identified risks of material misstatement, the auditor shall assess:

(a) The risks of material misstatement at the financial statement level. In doing so, the auditor shall determine whether such risks affect risks at the assertion level, and evaluate the nature and extent of their pervasive effect on the financial statements; and

(b) Inherent risk for identified risks of material misstatement at the assertion level by assessing the likelihood and magnitude of misstatement, and taking into account the inherent risk factors.

5.5.2. *The auditor uses professional judgment in determining the significance of the combination of the likelihood and magnitude of a misstatement on the spectrum of inherent risk. The assessed inherent risk relating to a particular risk of material misstatement at the assertion level represents a judgment within a range, from lower to higher, on the spectrum of inherent risk. The judgment about where in the range inherent risk is assessed may vary based on the nature, size and complexity of the entity, and takes into account the assessed likelihood and magnitude of the misstatement and inherent risk factors.*

5.5.3. The auditor shall determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material misstatement at the assertion level.

5.5.4. *Due to the nature of a risk of material misstatement, and the control activities that address that risk, in some circumstances the only way to obtain sufficient appropriate audit evidence is to test the operating effectiveness of controls. Accordingly, there is a requirement for the auditor to identify any such risks because of the implications for the design and performance of further audit procedures.*

Significant Risks

5.5.5. The auditor shall determine whether any of the assessed risks of material misstatement are, in the auditor's professional judgment, a significant risk.

5.5.6. *The determination of which of the assessed risks of material misstatement are close to the upper end of the spectrum of inherent risk, and are therefore significant risks, is a matter of professional judgment, unless the risk is of a type specified to be treated as a significant risk as set out below. Being close to the upper end of the spectrum of inherent risk will differ from entity to entity, and will not necessarily be the same for an entity period on period. It may depend on the nature and circumstances of the entity for which the risk is being assessed.*

5.5.7. In exercising professional judgment as to which assessed risks are significant risks, the auditor shall consider at least the following:

(a) Whether the risk is a risk of fraud (for example, because of management override of controls or a presumed risk of fraud such as in revenue recognition), the auditor shall treat identified fraud risks as significant risks;

(b) Whether the risk involves significant transactions with related parties. The auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks;

(c) How the inherent risk factors, such as the complexity of transactions and the degree of subjectivity in the measurement of financial information related to the risk, including those measurements involving a wide range of measurement uncertainty, have influenced the auditor's assessment on the spectrum of risk; and

(d) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

Assessing Control Risk

5.5.8. If the auditor plans to test the operating effectiveness of controls the auditor shall assess control risk, otherwise the risk of material misstatement is the same as the assessment of inherent risk.

Evaluation of the Procedures to Identify and Assess Risks of Material Misstatement and Reassessment of Risk

5.5.9. The auditor shall evaluate whether the audit evidence obtained from procedures to identify and assess the risks of material misstatement provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, the auditor shall perform additional procedures.

5.5.10. The auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment, the auditor shall revise the assessment and modify the further planned audit procedures accordingly.

Evaluation of the Applicability of the [Draft] Audit Standard

5.5.11. If information has been obtained after the original assessment was made to use this [draft] audit standard, the auditor shall evaluate the information and determine whether this audit standard continues to be appropriate for the nature and circumstances of the entity being audited.

5.6. Specific Inquiries of Management and Those Charged with Governance

5.6.1. In performing procedures to identify and assess the risks of material misstatement due to fraud or error, the auditor shall make inquiries of management regarding:

(a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments;

(b) Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist;

(c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity;

(d) Management's communication, if any, to employees regarding its views on business practices and ethical behavior;

(e) The identity of the entity's related parties, including changes from the prior period; the nature of the relationships between the entity and these related parties; and whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions; and

(f) Non-compliance with laws and regulations that may have a material effect on the financial statements, and inspecting correspondence, if any, with the relevant licensing or regulatory authorities.

(g) Events or conditions that exist that individually, or collectively, may affect the ability of the entity to continue as a going concern.

5.6.2. The auditor shall make inquiries of management, those charged with governance (if different to management), and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.

5.7. Specific Documentation Requirements

5.7.1. In addition to the general documentation requirements (paragraphs 2.7.1–2.7.6) for an audit engagement, the auditor shall include the following in the audit documentation:

(a) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control;

(b) The names of the identified related parties (including changes from prior period), the nature of the related party relationships, and whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions;

(c) The identified and assessed risks of material misstatement, including risks due to fraud, at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made;

(d) If applicable, the reasons for the conclusion that there is not a risk of material misstatement due to fraud related to revenue recognition.

(e) The controls set out in paragraph 5.3.18. and the evaluation whether the control is designed effectively and determination whether the control has been implemented; and

(f) For accounting estimates, the auditor shall document key elements of the auditor's understanding of the accounting estimates, including controls as appropriate, the linkage of the assessed risks of material misstatements to the auditor's further procedures, and any indicators of management bias and how those were addressed.

(g) Identified or suspected non-compliance with laws and regulations and the results of discussion with management and, where applicable, those charged with governance and parties outside the entity.

6. Responding to Assessed Risks of Material Misstatement

Part 6 deals with the:

- Design and implementation of an overall responses that are appropriate to assessed risks of material misstatement at the financial statement level;
- Design and implementation of an appropriate responses to the assessed risks of material misstatement at the assertion level (i.e., performance of further procedures). These further procedures include substantive procedures (tests of detail and substantive analytical procedures) and tests of control (as appropriate), and each is expanded on in this Part; and
- Procedures for specific topics when responding to assessed risks of material misstatement.

Part 2 sets out the broad requirements for audit evidence, as well as the types of procedures that may be used in the audit. In complying with the requirements in this Part, the auditor may find it useful to refer to the following paragraphs that set out relevant matters:

- *Substantive analytical procedures – see paragraph 2.3.3.*
- *Audit sampling – see paragraph 2.3.4.*
- *External confirmations – see paragraph 2.3.5.*
- *Considerations with regard to laws and regulations – see paragraphs 2.5.1. to 2.5.4.*

6.1. Objectives

6.1.1. The objectives of the auditor are to:

(a) Obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks;

(b) Respond, as appropriate, to risks of material misstatement arising from fraud;

(c) Obtain sufficient appropriate audit evidence regarding management's use of the going concern assumption and related disclosures; and

(d) To perform specified procedures to identify instances of non-compliance with laws and regulations and respond accordingly.

6.2. Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Financial Statement Level

6.2.1. The auditor shall design and implement overall responses to address the assessed risks of material misstatement (i.e., assessed risks) at the financial statement level, whether due to fraud or error.

6.2.2. *The auditor's overall responses are affected by the auditor's understanding of the control environment. The control environment provides a foundation for the operation of the other components of the system of internal control. The control environment does not directly prevent, or detect and correct, misstatements. It may, however, influence the effectiveness of controls in the other components of the system of internal control. Therefore an effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity. Deficiencies that have been identified in the control environment when obtaining an understanding of the entity's system of internal control, however, have the opposite effect* *and may result in the need for more extensive audit evidence from substantive procedures. A weak control environment also impacts the work that may be undertaken at an interim period.*

6.2.3. In determining overall responses to address assessed risks of material misstatement, due to fraud or error, at the financial statement level, the auditor shall:

(a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement;

(b) Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings; and

(c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures.

6.3. Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

6.3.1. The auditor shall design and perform further audit procedures whose nature, timing and extent are based on, and responsive to, assessed risks, whether due to fraud or error, at the assertion level.

6.3.2. *Further audit procedures are responsive to the assessed risk of material misstatement at the assertion level, and provide a clear linkage between the auditor's further procedures and the risk assessment. If the assessed risks of material misstatement are due to fraud risks at the assertion level, the nature timing and extent of audit procedures may need to be changed to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information.*

6.3.3. In designing the further audit procedures, the auditor shall:

(a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:

(i) The likelihood and magnitude of misstatement due to the characteristics of the significant class of transactions, account balance, or disclosure (that is, the inherent risk); and

(ii) Whether the risk assessment takes account of controls that address the risk of material misstatements (that is, the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (where the auditor plans to test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures);

(b) Obtain more persuasive audit evidence the higher the auditor's assessment of risk;

(c) Obtain more persuasive audit evidence the greater the reliance the auditor places on the operating effectiveness of controls; and

(d) Design and perform tests of controls when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

6.3.4. *When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for* *example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources*.

6.3.5. The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.

Tests of Controls

6.3.6. If the auditor is planning to place reliance on the effectiveness of controls, including group-wide controls or controls over the consolidation process in a group audit, the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of those controls that the auditor intends to rely on. If the control is a control over a significant risk, the auditor shall test the control in the current period.

6.3.7. When performing test of controls, the auditor shall perform audit procedures in combination with inquiry to obtain audit evidence about controls, including:

(a) How the controls were applied at relevant times during the period;

(b) The consistency with which they were applied; and

(c) By whom and what means they were applied.

6.3.8. The auditor shall determine whether the controls to be tested depend on other controls, and if so, consider whether it is necessary to obtain evidence about the effective operation of the other controls.

6.3.9. If deviations from controls, upon which the auditor intends to rely, are detected, the auditor shall make specific inquiries to understand deviations and the potential consequences, including whether the tests of controls provide an appropriate basis for reliance on the controls.

Substantive Procedures

6.3.10. Irrespective of the assessed risks, substantive procedures shall be performed for each material class of transactions, account balance, and disclosure.

6.3.11. The auditor's substantive procedures shall include audit procedures related to the financial statement closing process, including:

(a) Agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers; and

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

6.3.12. The auditor's substantive procedures shall include substantive procedures specifically responsive to significant. When the response to a significant risk consists only of substantive procedures, those procedures shall include tests of detail.

6.4. Specific Focus Areas

Going Concern

6.4.1. *In many cases, the management of less complex entities may not have prepared a detailed assessment of the entity's ability to continue as a going concern, but instead may rely on in-depth knowledge of the business and anticipated future prospects. Nevertheless, in accordance with the requirements of this standard, the auditor evaluates management's assessment of the entity's ability to continue as a going concern. For less complex entities, it may be appropriate to discuss the medium and long-term financing of the entity with management, provided that management's contentions can be corroborated by sufficient documentary evidence and are not inconsistent with the auditor's understanding of the entity*.

6.4.2. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. In doing so, the auditor shall cover the same period as used by management. If that period is less than twelve months from the date of the financial statements, the auditor shall ask management to extend the period. If management does not make or extend its assessment, the auditor shall consider the implications for the auditor's report (for example, a qualified opinion or disclaimer of opinion may be appropriate because the auditor is unable to obtain sufficient appropriate audit evidence).

6.4.3. *The auditor also remains alert to the possibility that there are known events, scheduled or otherwise, or conditions that will occur beyond the period of assessment used by management that may bring into question management's use of the going concern basis of accounting in preparing the financial statements. The further into the future the events or conditions are, the more significant the going concern issues need to be before the auditor takes further action. If events or conditions that may cast significant doubt on the entity's ability to continue as a going concern are identified after the auditor's risk assessments are made, the auditor's assessment of the risks of material misstatement may need to be revised.*

6.4.4. In evaluating management's assessment, the auditor shall consider whether management's assessment includes all relevant information of which the auditor is aware.

6.4.5. The auditor shall inquire of management as to its knowledge of events or conditions beyond the period of management's assessment that may cast significant doubt on the entity's ability to continue as a going concern.

6.4.6. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional procedures, including consideration of mitigating factors (a "material uncertainty" relates to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern).

Management Override of Controls

6.4.7. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, the auditor shall consider whether it is a risk of material misstatement due to fraud and therefore a significant risk.

6.4.8. Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:

(a) Test the appropriateness of manual and automated journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.

(b) Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud.

(c) For significant unusual transactions, evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.

6.4.9. *Material misstatement of financial statements due to fraud often involve the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries. This may occur throughout the year or at period end, or both, or by management making adjustments to amounts reported in the financial statements that are not reflected in journal entries, such as through consolidating adjustments and reclassifications.*

Related Parties

6.4.10. The auditor shall design and perform further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions.

6.4.11. For identified arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, the auditor shall:

(a) Determine whether the underlying circumstances confirm the existence of those relationships or transactions;

(b) Promptly communicate the relevant information to the other members of the engagement team;

(c) Where the applicable financial reporting framework establishes related party requirements:

(i) Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation;

(ii) Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions;

(d) Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions;

(e) Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor, and perform additional audit procedures as necessary; and

(f) If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit.

6.4.12. For significant related party transactions outside of the entity's normal course of business the auditor shall inspect the underlying contracts or agreements, if any, and evaluate whether:

(a) The business rationale (or lack thereof) for significant of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;

(b) The terms of transactions are consistent with management's explanations; and

(c) The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

6.4.13. If management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor shall obtain sufficient appropriate audit evidence about the assertion.

Accounting Estimates

6.4.14. The auditor's further audit procedures shall include one or more of the following approaches:

(a) Obtaining audit evidence from events occurring up to the date of the auditor's report. In doing so, the auditor shall take into account the changes in circumstances and other relevant conditions between the event and the measurement date that may affect the relevance of such evidence;

(b) Testing how management made the accounting estimate. In doing so, the auditor shall consider whether the method selected is appropriate, significant assumptions and the data used by management, whether judgments give rise to indicators of management bias, whether calculations are mathematically accurate and whether judgements have been applied consistently; or

(c) Developing an auditor's point estimate or range. In doing so, the auditor shall determine that the range includes only amounts that are supported by sufficient appropriate audit evidence and have been evaluated by the auditor to be reasonable in the context of the circumstances of the entity and the applicable financial reporting framework.

6.4.15. The auditor shall design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the assertion level for disclosures related to an accounting estimate.

Inventory

6.4.16. If inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(a) Attendance at physical inventory counting, unless impracticable, to:

(i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;

(ii) Observe the performance of management's count procedures;

(iii) Inspect the inventory; and

(iv) Perform test counts; and

(b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

6.4.17. If the auditor has not attended the inventory count, the auditor shall make or observe some physical counts on an alternative date, and perform audit procedures on intervening transactions. If attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory, or determine the effect on the auditor's report.

Group Audits

6.4.18. *To be completed once agreement on extent of group audits that will be included in the [draft] audit standard*.

Litigation and Claims

6.4.19. The auditor shall design and perform further audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

(a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;

(b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and

(c) Reviewing legal expense accounts.

Audit Procedures When Non-Compliance with Laws and Regulations is Identified or Suspected

6.4.20. If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall:

(a) Obtain an understanding of the nature and circumstances, and any further information necessary to evaluate the possible effect on the financial statements;

(b) Discuss the non-compliance with management, and where appropriate, those charged with governance, unless prohibited to do so by law and regulation;

(c) If sufficient information is not provided with regard to the non-compliance or suspected non-compliance:

(i) Using professional judgment, consider the need for legal advice;

(ii) Evaluate the effect of the lack of appropriate audit evidence on the auditor's opinion; and

(d) Evaluate the implications on other aspects of the audit, including the auditor's risk assessment and the reliability of written representations.

Using the Services of a Service Organization

6.4.21. If the entity is using the services of a service organization, the auditor shall:

(a) Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available at the entity; and, if not,

(b) Perform further audit procedures to obtain sufficient appropriate audit evidence or use another auditor to perform those procedures at the service organization on the auditor's behalf.

6.5. Specific Communication Requirements

6.5.1. The auditor shall communicate:

(a) In writing, significant deficiencies in the entity's system of internal control identified during the audit to those charged with governance on a timely basis.

(b) With management, on a timely basis, matters that have been communicated to those charged with governance or other deficiencies that have not been communicated but are of sufficient importance to merit management's attention.

6.5.2. Where the communications are in writing, the auditor shall include a description and explanation of the potential impact of the deficiencies, and sufficient information to describe the auditor's work and responsibilities in relation to those deficiencies.

6.5.3. In communicating with management and those charged with governance, the auditor shall consider the matters, if any, to communicate regarding accounting estimates, taking into account the reasons given to the risks of material misstatement relate to estimation uncertainty, or the effects of complexity, subjectivity or other inherent risk factors in making accounting estimates and related disclosures.

6.6. Specific Documentation Requirements

6.6.1. In addition to the general documentation requirements (paragraphs 2.7.1.–2.7.6) for an audit engagement, the auditor shall include the following in the audit documentation:

(a) The overall responses to the assessed risks of material misstatement at the financial statement level;

(b) The nature, timing and extent of further audit procedures performed in response to risks of material misstatement at the assertion level;

(c) The linkage between the procedures performed and the assessed risks at the assertion level;

(d) The results of the audit procedures, including the conclusions where these are not otherwise clear, and

(e) The results of audit procedures designed to address the risk of management override of controls.

6.6.2. Where the assessed risk of material misstatement is due to fraud, the auditor's documentation includes the specific fraud response.

6.6.3. Where the auditor has identified or suspected non-compliance with laws and regulations, the auditor shall document the audit procedures performed, the significant professional judgments made and the conclusions reached thereon.

6.6.4. For accounting estimates, the auditor shall include key elements of the auditor's understanding of the accounting estimates, including controls as appropriate, the linkage of the assessed risks of material misstatements to the auditor's further procedures, and any indicators of management bias and how those were addressed.

7. Concluding

Part 7 deals with the:

- Auditor's evaluations as to whether sufficient appropriate audit evidence has been obtained, including for relevant assertions, and other activities, to be able to conclude.
- Auditor's conclusion about management's use of the going concern assumption and related disclosures.
- Corrected and uncorrected misstatements identified during the audit.
- The auditor's consideration of the effect of subsequent events.
- Other concluding activities, including obtaining written representations and performing concluding analytical procedures.

7.1. Objectives

7.1.1. The objectives of the auditor are to:

(a) Evaluate the effect of identified misstatements on the audit and the effect of any uncorrected misstatements, if any, on the financial statements;

(b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

(c) Conclude on whether sufficient appropriate audit evidence has been obtained on which to base the auditor's opinion.

7.2. The Auditor's Evaluations and Other Activities to Support the Conclusion

7.2.1 Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate whether the assessments of the risks of material misstatement at the financial statement and assertion levels remain appropriate.

7.2.2. The auditor shall evaluate, based on the audit procedures performed and audit evidence obtained, whether:

(a) In respect of accounting estimates:

(i) The assessments of the risks of material misstatement at the assertion level remain appropriate, including when indicators of possible management bias have been identified;

(ii) Management's decisions relating to the recognition, measurement, presentation and disclosure of these accounting estimates in the financial statements are reasonable in the context of the applicable financial reporting framework (including, for a fair presentation framework, disclosures beyond those that are required but are necessary to achieve fair presentation of the financial statements as a whole have been provided); and

(iii) Sufficient appropriate audit evidence has been obtained.

(b) In respect of using the work of an auditor's expert, if applicable, the work for the purpose of the audit is adequate, including relevance and reasonableness of the expert's findings or conclusions, and consistency with other audit evidence. If the auditor determines that the work of the auditor's expert is not adequate for the purpose of the audit, the auditor shall perform additional audit procedures or agree with the auditor's expert on further procedures.

(c) With respect to the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, sufficient appropriate audit evidence has been obtained. The auditor shall conclude on management's use of the going concern basis of accounting.

(d) Adequate two-way communication between the auditor and those charged with governance occurred. If it has not, the auditor shall evaluate the effect, if any, and take action as appropriate (for example, modifying the auditor's opinion on the basis of a scope limitation or other actions as appropriate).

(e) The results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary.

7.2.3. If the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud, the auditor shall evaluate the implications on the audit including on the assessed risks of material misstatement and the auditor's report.

7.2.4. The engagement partner shall determine that members of the engagement team have undertaken appropriate consultation and determine that the conclusions agreed have been implemented.

7.2.5. *Consultation may be appropriate when there are issues that are complex or unfamiliar, significant risks, significant transactions that are outside the normal course of business, or that otherwise appear to be unusual, limitations imposed by management or non-compliance with laws and regulations*.

7.2.6. If an objective of a particular Part within this standard cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby require the auditor to modify the audit opinion.

Concluding

7.2.7. The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to be corroborative or contradictory to other information obtained.

7.2.8. If the auditor has not obtained sufficient appropriate audit evidence as to a relevant assertion, the auditor shall attempt to obtain additional audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or issue a disclaimer on the financial statements.

7.2.9. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's professional judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

7.2.10. The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework. In making this evaluation, the auditor shall consider whether the financial statements are presented in a manner that reflects the appropriate:

(a) Classification and description of financial information and the underlying transactions, events and conditions; and

(b) Presentation, structure and content of the financial statements

7.3. Evaluation of Misstatements Identified During the Audit

7.3.1. The auditor shall accumulate misstatements identified, other than those that are clearly trivial, throughout the audit.

7.3.2. *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, 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 misstatement is considered not to be clearly trivial.*

7.3.3. The auditor shall determine the impact on the identification and assessment of risks of material misstatement, and whether changes need to be made if the nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist, or misstatements accumulated during the audit approach materiality.

7.3.4. If the auditor identifies a misstatement during the audit, the auditor shall evaluate whether the misstatement is indicative of fraud. If there is such an indication, the auditor shall determine the implications on other aspects of the audit, including on the identified and assessed risks of material misstatement and the reliability of management representations. If the auditor identifies a misstatement that may be the result of fraud, and suspects that management is involved, the auditor shall reevaluate the risks of material misstatement due to fraud and the auditor's responses thereto.

7.3.5. *The implications of identified fraud depend on the circumstances. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of evidence previously obtained may be called into question, since there may be doubts about the completeness and truthfulness of representations made and about the genuineness of accounting records and documentation. There may also be a possibility of collusion involving employees, management or third parties.*

7.3.6. The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall:

(a) Reassess materiality to confirm whether it remains appropriate in the context of the entity's actual financial results;

(b) Consider the:

(i) Size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and

(ii) Effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

7.3.7. If management has examined a class of transactions at the auditor's request, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional procedures to determine whether misstatements remain.

7.4. Analytical Procedures that Assist When Forming an Overall Conclusion

7.4.1. The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity, including any indications of a previously unrecognized risk of material misstatement arising from fraud.

7.5. Subsequent Events

7.5.1. *Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events.*[4] *Such financial reporting frameworks ordinarily identify two types of events:*

(a) Those that provide evidence of conditions that existed at the date of the financial statements; and

(b) *Those that provide evidence of conditions that arose after the date of the financial statements.*

7.5.2. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.

7.5.3. The auditor shall perform procedures to cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor's procedures shall include:

(a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.

(b) Inquire of management, and where appropriate, those charged with governance, as to whether any subsequent events have occurred that may affect the financial statements.

(c) Reading minutes of meetings held after the balance sheet date.

7.5.4. If the auditor has identified events that require or adjustment in terms of the entity's applicable financial reporting framework, the auditor shall determine whether each such event is appropriately reflected in the financial statements.

7.5.5. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report or after the financial statements have been issued. However, if the auditor becomes aware of facts or events that may have an effect on the auditor's report:

(a) After the date of the auditor's report but before the financial statements are issued, or

(b) After the financial statements have been issued,

the auditor shall perform additional procedures and evaluate the impact on the auditor's report.

---

[4] For example, International Accounting Standard (IAS) 10, *Events After the Reporting Period*, deals with the treatment in financial statements of events, both favorable and unfavorable, that occur between the date of the financial statements (referred to as the "end of the reporting period" in the IAS) and the date when the financial statements are authorized for issue.

7.6. Written Representations

7.6.1. *Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence*. However, *although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.*

7.6.2. The auditor shall request written representations from management, having appropriate knowledge of the matters concerned and responsibility for the financial statements, and where applicable those charged with governance:

(a) That it has fulfilled its responsibility for the preparation of the financial statement in accordance with the applicable financial reporting framework;

(b) That it has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement;[5]

(c) That all transactions are recorded and are reflected in the financial statements;

(d) That it acknowledges its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud;

(e) That it has disclosed to the auditor the result of its assessment of the risk that the financial statements may be materially misstated because of fraud;

(f) That it has disclosed to the auditor their knowledge if fraud, or suspected fraud, or allegations of fraud or suspected fraud;

(g) It has disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which it is aware;

(h) It has appropriately accounted for and disclosed related party relationships and transactions in accordance with the requirements of the financial reporting framework;

(i) That all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor.

(j) That all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

(k) With regard to accounting estimates, whether the methods, significant assumptions and data used in making the accounting estimates and disclosures are appropriate to achieve recognition, measurement or disclosure is in accordance with the applicable financial reporting framework;

[5] The management representation shall be described in the same way as described in the terms of engagement.

(l) That all events occurring subsequent to date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed;

(m) With regard to going concern, if a material uncertainty exists, information about their plans for future actions and the feasibility of these plans; and

(n) Other representations the auditor determines necessary to support other audit evidence in the financial statements, including where necessary to support oral representations.

7.6.3. The written representation shall be in the form of a representation letter addressed to the auditor. Appendix X sets out an example management representation letter.

7.6.4. If managements' responsibilities are clearly defined in law and regulation, the auditor may determine not to obtain written representation about those matters already addressed.

7.6.5. The auditor shall request a written representation from management, and where appropriate those charged with governance, whether they believe the effects of uncorrected misstatements are immaterial, individually or in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

7.6.6. If the auditor has concerns about the reliability of management's representations, or representations are inconsistent with other audit evidence, the auditor shall determine the effect on audit evidence more generally and take appropriate actions, including the possible effect on the opinion in the auditor's report.

7.6.7. If management does not provide one or more of the requested written representations, the auditor shall:

(a) Discuss the matter with management.

(b) Reevaluate the integrity of management and evaluate the effect this may have on the reliability of oral and written representations and audit evidence in general; and

(c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

7.6.8. The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements.

7.7. Taking Overall Responsibility for Managing and Achieving Quality

7.7.1. Prior to dating the auditor's report, the engagement partner shall determine that overall responsibility for managing and achieving quality on the audit engagement has been taken.

7.8. Specific Communication Requirements

7.8.1. The auditor shall communicate with management on a timely basis. Matters to be communicated include:

(a) Significant findings from the audit, including:

(i) The auditor's views about qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

(ii) Significant difficulties, if any, encountered during the audit.

(iii) Identified control deficiencies.

(iv) Identified misstatements or potential misstatements.

(v) Identified or suspected fraud or information that indicates that a fraud may exist unless prohibited by applicable laws and regulations.

(vi) Identified or suspect non-compliance with laws or regulations with relevance for the audit.

(b) Circumstances, if any, that affect the form and content of the auditor's report.

(c) Written representations the auditor is requesting.

(d) Communication requirements under laws and regulation.

(e) Other significant matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the financial statements and the financial reporting process.

The auditor shall also communicate the above matters to those charged with governance if separate from management.

7.8.2. Unless all of those charged with governance are involved in managing the entity, the auditor shall communicate significant matters arising during the audit in connection with the entity's related parties and any other matters discussed with management (as relevant).

7.8.3. The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, and where appropriate, those charged with governance, and request those misstatements to be corrected. If some or all of the misstatements are not corrected, the auditor shall obtain an understanding of the reasons for not making the corrections and shall consider that understanding when evaluating whether the financial statements as a whole are free from material misstatement.

7.8.4. The auditor shall communicate with management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are material, individually and in aggregate, to the financial statements as a whole. The auditor's communication shall identify uncorrected misstatements individually, as well as the effect of uncorrected misstatements from prior periods.

7.8.5. Unless all those charged with governance are involved in managing the entity, the auditor shall communicate with those charged with governance events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern. Such communication with those charged with governance shall include the following:

(a) Whether the events or conditions constitute a material uncertainty;

(b) Whether management's use of the going concern basis of accounting is appropriate in the preparation of the financial statements;

(c) The adequacy of related disclosures in the financial statements; and

(d) Where applicable, the implications for the auditor's report.

7.9. Specific Documentation Requirements

7.9.1. In addition to the audit documentation requirements (paragraphs 2.7.1.–2.7.6) for an audit engagement, the auditor shall include the following in the audit documentation:

(a) Demonstration that information in the financial statements agrees or reconciles with the underlying accounting records, including disclosures.

(b) The amount below which misstatements would be regarded as clearly trivial, all misstatements accumulated during the audit and the auditor's conclusion on the uncorrected misstatements.

(c) If, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document:

(i) The circumstances encountered;

(ii) The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and

(iii) When and by whom the resulting changes to audit documentation were made and reviewed.

7.9.2 The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

7.9.3. *An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process if they are administrative in nature.*

7.9.4. After assembly of the final audit file is complete, the auditor shall not remove audit documentation of any nature before the end of its retention period (for example, a period of 5 years).

7.9.5. If applicable, the auditor shall document the failure to meet an objective of any Part of this [draft] audit standard, and the resulting action (such as the effect on the auditor's opinion or withdrawal from the engagement if the overall objective of the auditor cannot be met).

7.9.6. If the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor shall, regardless of the nature of the modifications or additions, document:

(a) The specific reasons for making them; and

(b) When and by whom they were made and reviewed.

8. Forming an Opinion and Reporting

Part 8 deals with the:

- Forming an opinion;
- The types of audit opinions; and
- The content of the auditor's report.

8.1. Objectives

8.1.1. The objectives of the auditor are to:

(a) Form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained and to express clearly that opinion through a written report; and

(b) Consider whether there is a material inconsistency between the other information, if any, and the financial statements as well as the auditor's knowledge obtained in the audit and respond appropriately.

8.2. Forming an Opinion on the Financial Statements

8.2.1. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion takes into account:

(a) Whether sufficient appropriate audit evidence has been obtained;

(b) Whether uncorrected misstatements, individually or in aggregate are material; and

(c) The evaluations required by paragraphs 8.2.2. to 8.2.5.

8.2.2. The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework and form an opinion thereon. The evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. In doing so, the auditor shall evaluate, in view of the applicable financial reporting framework:

(a) Whether the financial statements disclose the entity's significant accounting policies, and whether they have been presented in an understandable way;

(b) Whether the entity's accounting policies are applied consistently and are appropriate;

(c) The accounting estimates made by management are reasonable;

(d) Whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework;

(e) The information presented in the financial statements is relevant reliable, comparable and understandable;

(f) Whether the financial statements provide adequate disclosures to enable intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and

(g) The terminology used in the financial statements is appropriate.

8.2.3. If the financial statements are prepared in accordance with a fair presentation framework, the auditor shall also evaluate whether the financial statements achieve fair presentation.

8.2.4. *Some financial reporting frameworks acknowledge explicitly or implicitly the concept of fair presentation. A fair presentation financial reporting framework not only requires compliance with the requirements of the framework, but also acknowledges explicitly or implicitly that it may be necessary for management to provide disclosures beyond those specifically required by the framework. The auditor's evaluation about whether the financial statements achieve fair presentation, both in respect of presentation and disclosure, is a matter of professional judgment*.

8.2.5. The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.

8.3. Form of Opinion

8.3.1. The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

8.3.2. If the auditor concludes that the financial statements are not free from material misstatement, or is unable to obtain sufficient appropriate audit evidence, the auditor shall modify the auditor's opinion.

8.3.3. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report.

8.4. Auditor´s Report

8.4.1. The auditor's report shall be in writing and shall[6]:

(a) Have a title that clearly indicates that it is the report of an independent auditor.

(b) Identify the entity whose financial statements have been audited; identify each financial statemen, notes and significant accounting policies and the date and period covered; and identify the financial reporting framework that has been applied in the preparation;

(c) Include a description of the scope of the audit which shall identify the audit was conducted [in accordance with this standard] (TBC).

(d) Include a statement that the auditor is independent of the entity in accordance with relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.

---

[6] Depending on regulatory requirements there might be additional reporting requirements, such as;

- express an opinion on:
  - whether the management report is consistent with the financial statements, and
  - whether the management report has been prepared in accordance with the applicable legal requirements;
- if applicable, state whether, in the light of the knowledge and understanding of the undertaking and its environment obtained in the course of the audit, he, she or it has identified material misstatements in the management report, and shall give an indication of the nature of any such misstatements.

(e) Include a section describing managements responsibilities for preparing the financial statements in accordance with the applicable financial reporting framework, and assessing the entity's ability to continue as a going concern and use of the going concern basis of accounting;

(f) Include a section describing the auditor's responsibilities for the audit of the financial statements;

(g) State whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

(h) Express an opinion, which shall be either unqualified, qualified or an adverse opinion and shall state clearly the opinion as to:

  (i) Whether the annual financial statements give a true and fair view in accordance with the relevant financial reporting framework, or

  (ii) Whether the annual financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework; and,

  (iii) Where appropriate, whether the annual financial statements comply with statutory requirements.

(i) Be signed and dated, and identify the place of establishment of the statutory auditor(s) or the audit firm(s). The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.

Appendix X sets out an example auditor's report.

8.4.2. When the financial statements are prepared in accordance with a fair presentation framework, the description of responsibilities for the financial statements in the auditor's report shall refer to "the preparation and fair presentation of these financial statements" or "the preparation of financial statements that give a true and fair view," as appropriate in the circumstances.

8.5. Modified Opinions

Nature of Matter Giving Rise to the Modification	*Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements*	
	Material but Not Pervasive	*Material and Pervasive*
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

8.5.1. When modifying the opinion, the auditor provides:

(a) A qualified opinion when the auditor:

(i) Having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements;

(ii) Is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive. or

(iii) In the auditor's professional judgment management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate in the circumstances but a material uncertainty exists that is not adequately disclosed in the financial statement.

(b) An adverse opinion when the auditor concludes that:

(i) Misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

(ii) In the auditor's professional judgment managements use of the going concern basis of accounting in the preparation of the financial statement is inappropriate.

(c) A disclaimer of opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to form an audit opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Other Circumstances Where a Modification is Required

8.5.2. If the auditor identifies or suspects non-compliance with laws and regulations that have a material affect on the financial statements:

(a) If the auditor concludes that the non-compliance with laws and regulations has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion;

(b) If the auditor is precluded from obtaining sufficient appropriate audit evidence about whether the non-compliance has, or is likely to have occurred, the auditor shall express a qualified opinion or disclaim an opinion on the basis of a limitation on the scope of the audit; or

(c) If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor's opinion.

Content of the Auditor's Report When the Opinion Is Modified

8.5.3. When the auditor modifies the audit opinion, qualified opinion, adverse opinion or disclaimer of opinion, the auditor shall:

(a) Amend the heading "Basis for Opinion" as appropriate; and

(b) Within the basis of opinion section, include a description of the matter giving rise to the modification; and

(c) Include a section in the auditor's report with the heading for the Opinion section as appropriate.

Qualified Opinion

8.5.4. When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section:

(a) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) […] in accordance with [the applicable financial reporting framework]; or

(b) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework]. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion.

Adverse Opinion

8.5.5. When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:

(a) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) […] in accordance with [the applicable financial reporting framework]; or

(b) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

Disclaimer of Opinion

8.5.6. If the auditor is unable to express an opinion, the report shall contain a disclaimer of opinion:

(a) State that the auditor does not express an opinion on the accompanying financial statements;

(b) Refer to any other matters or emphasis of matter paragraphs to which the auditor draw attention without qualifying the audit opinion;

(c) Provide a statement on any material uncertainty relating to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern;

(d) State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements;

(e) Amend the statement which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements;

(f) Be signed and dated, the date of the audit report shall be no earlier than the date on which the auditor obtained sufficient appropriate audit evidence; and

(g) Identify the place of establishment of the statutory auditor(s) or the audit firm(s).

8.6. Other Paragraphs in the Auditor's Report

Emphasis of Matter Paragraphs

8.6.1. If the auditor considers it necessary to draw users attention to a matter presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to the users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report indicating that the auditor's report is not modified in respect of the matter emphasized.

Other Matter Paragraphs

8.6.2. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to the users' understanding of the audit, the auditor's responsibilities or the auditor's report the auditor shall include an Other Matter paragraph in the auditor's report provided this is not prohibited by law or regulation.

Material Uncertainty Related to Going Concern

8.6.3.If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether adequate disclosure about a material uncertainty related to going concern is made, including management's plans to deal with the events and conditions, in the financial statements. In such cases, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Relating to Going Concern, to:

(a) Draw attention to the note in the financial statements that discloses the matters related to the material uncertainty; and

(b) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

8.6.4. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

8.6.5. If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.

8.6.6. If adequate disclosures are not made about the material uncertainty, the auditor shall qualify the audit opinion or issue an adverse opinion.

8.7. Comparative Information

8.7.1. The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework. In doing so, the auditor shall evaluate whether the amounts and disclosures in the prior period have been restated, and the accounting policies reflected in the comparative information are consistent with those applied in the current period.

8.8. Other Information

8.8.1. *“Other information” is financial or non-financial information (other than the financial statements and the auditor’s report thereon) included in an entity’s annual report.*

8.8.2. The auditor shall read the other information to consider whether there is a material inconsistency between the other information and the financial statements, or with the auditor’s knowledge.

8.8.3. The auditor shall document the procedures performed in relation to other information.

Appendices

The following Appendices will be appended to the [draft] audit standard:

- Assertions
- Fraud risk factors for LCEs
- Draft engagement letter
- Draft management representation letter
- Draft auditor’s report (unmodified opinion)