

AG ISA (NZ) 315 (REVISED)
THE AUDITOR-GENERAL'S STATEMENT ON
IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL
MISSTATEMENT THROUGH UNDERSTANDING THE
ENTITY AND ITS ENVIRONMENT

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Introduction

Scope of this Statement

1. This Auditor-General's Auditing Statement:
 - (a) establishes the Auditor-General's requirements in relation to ISA (NZ) 315 (Revised): *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment* (ISA (NZ) 315);¹ and
 - (b) provides additional guidance to reflect the public sector perspective.

Application

2. Compliance with this Statement is mandatory for Appointed Auditors who carry out annual audits on behalf of the Auditor-General. This Statement requires compliance with all of the requirements of ISA (NZ) 315, except to the extent that this Statement provides otherwise. Where a conflict between this Statement and ISA (NZ) 315 exists, the requirements of this Statement shall prevail.
3. This Statement applies to audits of financial statements and/or performance information which has been prepared for reporting periods beginning on or after 1 April 2017.

Objectives

4. The objectives of the Appointed Auditor are to:
 - (a) identify and assess the risks of material misstatement, whether due to fraud or error, in the financial statements and performance information at the assertion level, through understanding the entity and its environment, including the entity's internal control, and thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement;
 - (b) maintain alertness and awareness for, and if necessary assess, risks that the public entity may not:
 - (i) apply its resources effectively and efficiently;
 - (ii) minimise waste;
 - (iii) conduct its business with due regard to probity; and
 - (iv) act in a financially prudent manner.

¹ The ISA (NZ) auditing standards are scoped so that they apply to audits of "historical financial information". However, for the purposes of the Auditor-General's auditing standards and statements, all references to "historical financial information" should be read as the audit of "historical financial and historical performance information".

- (c) obtain, for public entities identified by the OAG, to the level necessary, an understanding of internal control in a public entity that may be used by the OAG to report matters to Parliament on the quality of the internal control in public entities, at an individual, sector, or national level.

Definitions

- 5. For the purpose of this Auditor-General's auditing statement the defined terms have the meanings attributed:
 - (a) in the Glossary of Terms issued by the New Zealand Auditing and Assurance Standards Board (the NZAuASB glossary) of the External Reporting Board (although where a term with a specific meaning in the New Zealand public sector differs from the NZAuASB glossary, the New Zealand public sector definition shall prevail); and
 - (b) in the Auditor-General's Glossary of Terms.

Requirements

Understanding the entity's internal control

- 6. As well as the requirements in paragraph 12 of ISA (NZ) 315 (Revised), the Appointed Auditor shall consider, where it is appropriate, whether:
 - (a) there is a long-term planning process that results in credible long-term business and strategic plans;
 - (b) planning processes involve the specification of both financial and performance information that is appropriate both for managing the public entity and reporting externally;
 - (c) there is forecast financial and performance information that is consistent with the public entity's business or strategic plans;
 - (d) the forecast financial and performance information has been compiled with input from those charged with governance and appropriate levels of management; and
 - (e) the forecast financial and performance information is detailed enough to enable effective and frequent monitoring of actual performance against it.

- 7. Also, in addition to the requirements in paragraph 12 of ISA (NZ) 315 (Revised), the Appointed Auditor shall remain alert for and aware of risks that the public entity may not take appropriate account of the public sector factors that are the focus of AG-3: *The auditor's approach to issues of effectiveness and efficiency, waste and a lack of probity or financial prudence* and AG ISA (NZ) 250: *Consideration of laws and*

regulations. This may involve considering whether the entity's internal control provides assurance that the entity has:

- (a) applied its resources effectively and efficiently;
- (b) complied with its statutory obligations;
- (c) minimised waste;
- (d) conducted its business with due regard to probity; and
- (e) acted in a financially prudent manner.

8. As well as the requirements in paragraph 15 of ISA (NZ) 315 (Revised), the Appointed Auditor shall consider, where it is appropriate, whether the public entity has appropriate risk management policies and procedures to manage risks, including political issues, demographic trends, and natural disasters.
9. In keeping with paragraph 11(d) of ISA (NZ) 315 (Revised), the Appointed Auditor shall take into account the additional examples of conditions and events that may indicate risks of material misstatement in Appendix 1.
10. The Appointed Auditor shall, if relevant to gaining an understanding of the public entity, consider the findings from any other work of the OAG (such as performance audits, inquiries, or audits of Long-Term Plans) or any external reviews. External reviews may include:
 - (a) the involvement of external parties such as industry associations, Ministers, and control agencies (such as the Treasury and the State Services Commission) and the extent to which this involvement affects internal control; or
 - (b) any other external influences that affect the Appointed Auditor's understanding of internal control, such as industry influences; and
 - (c) the findings of any external reviews conducted on the public entity that may influence the Appointed Auditor's understanding of any aspect of internal control.
11. The Appointed Auditor shall immediately report the findings of any substantial or significant external reviews of the activities of the public entity to the OAG.

Appendix 1 – Examples of conditions and events that may indicate risks of material misstatement in the financial and performance information

The following are examples of conditions and events that may indicate risks of material misstatement for public entities. The examples are additional to those in Appendix 2 of ISA (NZ) 315 (Revised). They include:

- major changes to existing programmes;
- new legislation and regulations or directives;
- new programmes, products or services;
- new performance measures;
- new systems for recording financial and performance information;
- political decisions such as relocation of operations;
- increased public expectations;
- matters of high public interest, which may lead to expectations to meet targets;
- changes in ownership arrangements;
- changes in political leadership;
- public private partnerships;
- outsourcing of government activities;
- higher than normal expectations to meet budget;
- budget overspending due to weak budgetary controls;
- programmes without sufficient allocated resources and funding;
- indications of non-compliance with statutory obligations;
- indications of a lack of effectiveness or efficiency, waste, a lack of probity or financial prudence; and
- operations subject to special investigations.