

## ISA 315 (Revised)—Issues and Recommendations

### Objective of the IAASB Discussion

The objective of this agenda item is to consider the International Standards on Auditing (ISA) 315<sup>1</sup> Task Force's (the Task Force) proposed recommendations with respect to:

- (a) Proposed conforming amendments to the other ISAs arising from the proposed changes to ISA 315 (Revised); and
- (b) New and revised definitions related to information technology (IT).

### Introduction and Overview of Agenda Item

1. This paper sets out Task Force views about proposed changes to aspects of ISA 315 (Revised) and related changes to the other ISAs arising from proposed changes to ISA 315 (Revised), which have not been previously considered by the Board. In addition, the appendices to this paper set out a summary update (i.e., no further Board action required) relating to further considerations by the Task Force regarding the scalability of the standard (Appendix 1) as well as progress on further changes relating to IT (Appendix 2). References in this paper to requirements and application material in relation to ISA 315 (Revised) are to the proposed changes to ISA 315 (Revised) that were presented for Board discussion in March 2018 (Agenda Items 3-A and 3-B).
2. With regard to the matters for discussion on the Board teleconference, the Task Force's considerations are presented as follows:
  - (i) **Section I** sets out the Task Force's views on the proposed conforming amendments and consequential amendments arising from draft Exposure Draft (ED) ISA 315 (Revised). **Agenda Item 1-A** supports the proposed changes as explained in Section I below.
  - (ii) **Section II** sets out the Task Force's views on changes to modernize the definitions of 'General IT Controls' and 'Application Controls in Information Technology, as well as additional proposals by the Task Force to modernize the current glossary definitions of 'IT Environment' and 'Access Controls'.
3. The Task Force continues to coordinate with the ISA 540<sup>2</sup> Task Force as the ISA 315 and ISA 540 projects progress. Matters of particular relevance to this IAASB teleconference include the conforming amendments to ISA 540—see paragraph 6.

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<sup>1</sup> International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.

<sup>2</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

**I. Proposed Conforming Amendments Arising from the Proposed Revisions to ISA 315 (Revised)**

4. In considering the conforming and consequential amendments to the ISAs arising from the proposed changes to ISA 315 (Revised) that will be presented with the ED of ISA 315 (Revised) (ED), the Task Force is proposing the following approach:

- For standards where there are expected to be a greater volume of changes, and in some instances consequential changes because of amended concepts in ISA 315 (Revised), the specific ISA with proposed conforming amendments is presented in **Agenda Item 1-A**. This applies to the following standards:
  - ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*
  - ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*
  - ISA 330, *The Auditor's Responses to Assessed Risks*

Further explanation for the proposed conforming amendments has been provided below.

5. In relation to conforming amendments in the other ISAs that are not presented in **Agenda Item 1-A**, a *description of the changes*, explaining what the changes will be with relevant examples, is set out below. As there are numerous changes throughout the ISAs, and as these changes are, in the Task Force's view, generally straightforward, the Task Force believes that this presentation is a more sensible approach for the purpose of the ISA 315 (Revised) ED (i.e., rather than providing respondents with a substantial number of pages of conforming amendments). However, to the extent that these proposed conforming amendments apply to the three specific standards noted in paragraph 4 above, these changes will be presented as a mark-up to those specific standards.

6. For the purpose of this Board teleconference, no changes have been presented in relation to ISA 540 (Revised). At this time, the proposed standard is being finalized and changes are still being progressed in relation to paragraphs in the final approved version of ISA 540 (Revised) that will need to be conformed in the ISA 315 (Revised) project. Furthermore, changes may still be made as ISA 540 (Revised) is finalized at the June 2018 IAASB meeting. Accordingly, the Task Force proposes that the conforming changes to ISA 540 (Revised) will be presented to the Board for approval on one of the Board teleconferences in the third quarter of 2018.<sup>3,4</sup> Once approved, the conforming amendments in respect of ISA 540 (Revised) would be released as a supplement to the ED. Although this will be a slight delay after the ED of ISA 315 (Revised) is publicly exposed, respondents will be requested to submit comments on the conforming amendments to ISA 540 (Revised) by the same closing date as the ED. As these changes are expected to be limited, and because the Task Force continues to work with the ISA 540 Task Force regarding the changes that are being made in ISA 540 (Revised), the Task Force does not believe that exposing these at a slightly later date than the rest of the ED and other conforming amendments will impact due process.

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<sup>3</sup> Subject to the approval (without re-exposure) of ISA 540 (Revised) by the IAASB in June 2018, otherwise the approach will need to be revisited. The ISA 315 Task Force will continue to monitor changes to ISA 540 (Revised) during the June 2018 IAASB meeting and consider the impact on the conforming changes that will need to be made.

<sup>4</sup> These conforming amendments would also include further changes to ISA 200, paragraph A42, which is currently under revision in the ISA 540 project.

*Changes to ISA 200, ISA 240 and ISA 330*

7. As noted in paragraph 5 above, the more ‘straightforward’ conforming changes have been presented in **Agenda Item 1-A** where they apply. In respect of the other conforming amendments shown in **Agenda Item 1-A**, the rationale for these changes is explained further in the paragraphs that follow. These proposed conforming amendments are based on the requirements and application material as presented at the March 2018 IAASB meeting. However, as changes are still being progressed that may necessitate further changes to the underlying paragraphs, any such further changes will be made accordingly.

ISA 200

8. ISA 200 explains the overall concepts used in the ISAs, including in relation to audit risk and risks of material misstatement. In revising ISA 315 (Revised), new concepts relating to the ‘spectrum of inherent risk’, ‘inherent risk factors’, ‘relevant assertions’ and ‘significant classes of transactions, account balances and disclosures’ have been introduced as part of the risk assessment process. Accordingly, the Task Force proposes that changes are made in ISA 200 to introduce these new concepts—see paragraph A40. In addition, a new paragraph A42a has been proposed to help align the explanation of the risk assessment process with the responses required to address risks of material misstatement in accordance with ISA 330.
9. No further changes have been made to paragraph A42 as this paragraph is also currently being amended by the ISA 540 project. As noted above, the Task Force will address final changes to this paragraph together with other conforming changes to ISA 540 once that standard has been finalized.

ISA 240

10. The Task Force continues to consider how risks of material misstatement due to fraud have been referenced in ISA 315 (Revised), including how fraud is addressed in the inherent risk factors. In particular, the Task Force continues to coordinate with the ISA 540 Task Force as they make changes to address this aspect of that project. In **Agenda Item 1-A**, changes have been proposed to paragraph A25 of ISA 240, and Appendix 1, to explain the intended relationship between the fraud risk factors and the inherent risk factors in ISA 315 (Revised). Such changes have been made under the assumption that ISA 315 (Revised) will include ‘susceptibility to misstatement due to management bias or fraud’ as an inherent risk factor consistent with the ISA 540 proposal to refer to this factor, as discussed during the ISA 540 (Revised) April Board teleconference.
11. The Task Force’s further considerations about the inherent risk factors, and further changes to ISA 315 (Revised), will be presented for discussion at the June 2018 IAASB meeting.
12. Conforming amendments are also proposed in ISA 240 to reflect the new concepts introduced in ISA 315 (Revised) as follows:
  - Paragraph 7—control procedures has been changed to ‘controls’ – the new definition of controls sets out that controls are policies and procedures.
  - Paragraph A42 (third bullet) – automated steps and procedures has been changed to “automated controls.”
13. In revising ISA 315 (Revised), significant effort has been made to clarify the work effort related to obtaining an understanding of the components of the entity’s system of internal control, and relating to ‘controls relevant to the audit.’ As fraud very often is related to control aspects, some of the paragraphs in ISA 240 have been conformed to be consistent with the changes being proposed in ISA 315 (Revised):

- Paragraph 27—more explicitly stating that controls over fraud risks are controls relevant to the audit, (a footnote to paragraph 20(b) in ISA 315 (Revised) has been added)—and accordingly, the auditor would be required to evaluate the design of those controls and determine whether they have been implemented in accordance with paragraph 21B of ISA 315 (Revised).
  - Paragraph 44(c)—this is a new requirement to specifically document controls relevant to the audit that are related to assessed risks of material misstatement due to fraud; this requirement is to conform to the proposed new requirement in paragraph 32(c) of ISA 315 (Revised) to document controls relevant to the audit.
  - Paragraphs A7 and A32—focusing on controls relevant to the audit when considering the controls over the information to be used as audit evidence and in understanding the controls that management has implemented to prevent and detect fraud .
  - Paragraph A43 (last bullet)—‘level of internal control’ is not a term used in ISA 315 (Revised), this has been changed to ‘nature and extent of controls’ which is consistent with the way control risk has been described in ISA 315 (Revised) for the purpose of determining an appropriate response to identified risks of material misstatement.
14. A new footnote reference has been added to paragraph A42, to explicitly link this paragraph to the requirement relating to controls relevant to the audit related to journal entries (paragraph 20(c) in ISA 315 (Revised)), as this paragraph further explains more about the override of controls by way of journal entries.

#### ISA 330

15. In considering the conforming amendments to ISA 330, the Task Force has been mindful of maintaining the balance between conforming (or consequential) amendments, and more substantial changes that would not be within the scope of the ISA 315 (Revised) project. The Task Force is of the view that the more robust (and specific) process to identify and assess risks of material misstatement will result in auditors developing more targeted responses in accordance with the requirements of ISA 330. Several changes are being proposed to ISA 330 to better match the required responses with the enhancements made in ISA 315 (Revised) , including in:
- Paragraph A10—ISA 315 (Revised) has been revised to make clear that the operating effectiveness of controls has to be tested to assess control risk at less than maximum.
  - Paragraphs A29 to A31—no changes have been proposed yet – see paragraph 5 of Appendix 2 of this paper for related Task Force work.
  - Paragraph A45—more directly linking the response to the changes in ISA 315 (Revised) which require a more granular identification and assessment process.
16. Conforming amendments are also proposed in ISA 330 to reflect the new concepts introduced in ISA 315 (Revised) as follows:
- Paragraphs 7 and 27—introducing the new concept of ‘significant’ classes of transactions, account balances and disclosures to align with ISA 315 (Revised). Paragraph 27 has also been further aligned to changes proposed to paragraph 18 relating to classes of transactions, account balances or disclosures that are quantitatively or qualitatively material, but for which no risks of material misstatement have been identified.
  - In assessing the risks of material misstatement, ISA 315 (Revised) explains that the likelihood and magnitude are taken into account in order to assess where a risk of material misstatement is

positioned on the spectrum of inherent risk. Likelihood was already identified in paragraph 7, but this requirement has been conformed to ISA 315 (Revised) by also including magnitude. Paragraph A9 (which is the application material to paragraph 7) has also been enhanced to explain that the assessment of the auditor's risks of material misstatement is determined by the likelihood and magnitude of possible misstatement, and also impacted by the inherent risk factors.

- Paragraph A4—conforming to changes proposed to paragraph 18, as presented to the IAASB in March 2018 (see Agenda Item 3, paragraph 44), have been reflected in relation to classes of transactions, account balances and disclosures that are quantitatively or qualitatively material.
  - Paragraph A15—the Task Force considered whether to include a more explicit reference to 'spectrum of risk' (now included more explicitly in ISA 315 (Revised)), but agreed that on balance this change was not necessary. This paragraph refers to assessed risk, i.e., starts with the output of the risk identification and assessment process performed in accordance with ISA 315 (Revised) which will result in risks having been assessed along the spectrum of inherent risk.
  - Paragraph A42—the introduction of the concept of significant classes of transactions, account balances or disclosures has affected the way that paragraph 18 of ISA 330 operates. Many of the classes of transactions, account balances or disclosures that are quantitatively or qualitatively material will also be identified as significant under ISA 315 (Revised). Accordingly, further audit procedures to address the risks of material misstatement related to these significant classes of transactions, account balances or disclosures are performed in terms of paragraph 6 of ISA 330. Provided the further audit procedures include substantive procedures, no further action will be necessary to address the requirement in ISA 330, paragraph 18, in respect of the significant classes of transactions, account balances or disclosures. However, if the further audit procedures include only tests of controls, then substantive procedures will be required to address the requirement in ISA 330, paragraph 18. Additionally, ISA 330, paragraph 18 (and paragraph A42), will apply to those classes of transactions, account balances or disclosures that are quantitatively or qualitatively material but not significant (i.e., for which no risks of material misstatement have been identified) and which have been identified in accordance with ISA 315 (Revised), paragraph 30B. Clarifying changes have been made to paragraph A42 and the guidance related to substantive procedures in paragraphs A42–A52 have been linked to paragraph 6 of ISA 330. In addition, paragraph A42a has been added to provide further guidance about the substantive procedures to be performed (i.e., in order to appropriately address the requirement, the procedures need to be designed taking into account how risks of misstatement could exist that have increased likelihood of giving rise to material misstatement).
  - Paragraph A60—conforming to the new concepts introduced in ISA 315 (revised) relating to 'relevant assertions' and 'significant classes of transactions, account balances and disclosures.'
17. In determining controls relevant to the audit in accordance with paragraph 20 in ISA 315 (Revised), it has been proposed that this determination takes into account other indirect controls (see paragraphs A100h to A102 of ISA 315 (Revised)). Accordingly, this determination is now acknowledged in a proposed change in paragraph 10(b). However, the Task Force has not presented conforming changes yet in respect of paragraphs A29 to A31 to provide further context. As the Task Force finalizes its proposed changes in relation to matters related to IT, further changes to these paragraphs will be considered and presented as necessary.
18. Paragraph 14 has been conformed to proposed changes to paragraph 9 of ISA 315 (Revised), which now acknowledges that information from prior year audits remains relevant and reliable as audit evidence.

19. In making amendments to ISA 315 (Revised), the Task Force has focused on clarifying matters related to the risks of material misstatement at the financial statement level, including appropriate overall responses to these risks. Changes were proposed to paragraph A126c for March 2018 Board discussion, reflecting possible overall responses where a risk of material misstatement at the financial statement level has been identified and assessed. In further considering this, the Task Force is of the view that this material more appropriately belongs in ISA 330 and paragraph A1 has been amended accordingly. Paragraph A126c of ISA 315 (revised) will be deleted as these matters are now proposed in ISA 330.

*Changes in the Other ISAs that Have Not Been Presented*

20. Where changes have been made to describe a concept or matter in ISA 315 (Revised), the Task Force has considered changes to the existing concept or matter throughout the ISAs. These changes have been made in the ISAs presented in **Agenda Item 1-A**, but for the other ISAs not presented a description of the proposed change follows explaining where these changes will be needed. As applicable, the changes will also be made in the Glossary.

Extant Term in the ISAs	Change made in proposed ISA 315 (Revised)	Comments
Internal control	The system of internal control / controls	<p>The ‘<u>system of internal control</u>’ in ISA 315 (Revised) is defined as being comprised of the five components of internal control, with each of the components further explained in ISA 315 (Revised). The Task Force has agreed that any changes related to ‘internal control’ will need to be considered on a case by case basis throughout the ISAs:</p> <p>The term ‘internal control’ is a process to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance, i.e., it is used sometimes in the broader sense of internal control (i.e., more than just the five components of internal control as described in ISA 315 (Revised)). ISA 315 (Revised) relates to the system of internal control <i>relevant to financial reporting</i>, but the entity’s internal control, as described above, would be broader than only financial reporting.</p> <p>Where the term is used to refer to the five components of internal control as described in ISA 315 (Revised) (i.e., the system of internal control) the change will be made. Sometimes the term ‘internal control’ has been used to describe controls (i.e., the policies and procedures that represent the control), not necessarily the <i>system</i> of internal control. For example, this distinction can be made when using the term ‘inherent limitations of internal control.’ It is likely that the limitations attach to the controls themselves, and not</p>

Extant Term in the ISAs	Change made in proposed ISA 315 (Revised)	Comments
		<p>the whole system. In such cases, where the concept is referring to controls, the term ‘internal control’ will be changed to ‘controls’ to reflect this.<sup>5</sup> If the term is referring to the whole system (in total), then the change to ‘system of internal control’ will be made.</p> <p>However, where an ISA involves a document that is externally issued (such as an engagement letter in ISA 210<sup>6</sup> or management representation letter in ISA 580),<sup>7</sup> or related to these standards, the Task Force is of the view that the costs of such a change would not outweigh the benefits, in particular for external stakeholders who may find such a technical change not practical or difficult to understand. The Task Force’s rationale to adopt the term “system of internal control” in ISA 315 (Revised) is for the purpose of clarifying the auditor’s required understanding, and not for the purpose of changing the responsibilities of management for internal control. Accordingly, the Task Force is proposing to not making changes in ISA 210 and ISA 580 (or where related to these standards) for ‘internal control.’<sup>8</sup> Similarly, when the ISAs make reference to the possibility of the auditor being required to provide an assurance opinion on an entity’s “internal control,” the reference has not been changed.</p> <p>With respect to the auditor reporting standards (ISA 700 (Revised),<sup>9</sup> ISA 701,<sup>10</sup> ISA 800 (Revised),<sup>11</sup> ISA 805 (Revised)<sup>12</sup> and ISA 810 (Revised)<sup>13</sup>), including the template auditor’s reports within these standards, the Task Force is not proposing to make the changes to the term ‘internal control’ at this time. Changes in respect of</p>

<sup>5</sup> For example, in ISA 200 paragraph A41 the change will be made.

<sup>6</sup> ISA 210, *Agreeing the Terms of Audit Engagements*

<sup>7</sup> ISA 580, *Written Representations*

<sup>8</sup> For example, in ISA 200, paragraphs 13j(ii) and A2(b), and ISA 240, paragraph A12, the change will not be made.

<sup>9</sup> ISA 700, *Forming an Opinion and Reporting on Financial Statements*

<sup>10</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

<sup>11</sup> ISA 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*

<sup>12</sup> ISA 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement.*

<sup>13</sup> ISA 810 (Revised), *Engagements to Report on Summary Financial Statements*

Extant Term in the ISAs	Change made in proposed ISA 315 (Revised)	Comments
		<p>these standards have recently become effective, and updating the current reference to “internal control relevant to the audit” in the auditor’s responsibilities section would require a pervasive change across the template auditor’s reports. In addition, in light of the expected post-implementation review and possible further changes that may result, the Task Force is of the view that any changes in respect of ‘internal control’ are made at the same time as any other changes that may come out of the post-implementation review.</p>
Deficiency in internal control	Control deficiency	<p>A ‘deficiency in internal control’ in ISA 265<sup>14</sup> is defined to be a deficiency related to design, implementation, operation or omission of ‘a control.’ The Task Force is of the view that it would therefore not be appropriate to change this term to be a ‘deficiency in the system of internal control.’ Instead the Task Force proposes that the defined term of ‘deficiency in internal control’ be updated to ‘control deficiency’ to better align with its articulated definition, which focuses on ‘a control.’</p> <p>The Task Force recognizes, however, that such a change in terminology (along with the proposed change to ‘significant deficiency in internal control’ below) will result in pervasive changes to ISA 265 and across the ISAs, including as it relates to communications with those charged with governance. Accordingly, the Task Force is seeking specific input from the Board on the proposal to change these terms.</p>
Significant deficiency in internal control	Significant control deficiency	<p>See explanation above – the same principles apply. A ‘significant deficiency in internal control’ is defined as a deficiency or combination of deficiencies in internal control.<sup>15</sup> Based on the proposed change to ‘control deficiency’ above, this term would be amended to ‘significant control deficiency’ and the definition would be updated to ‘a deficiency or combination of control deficiencies’ that, in the auditor’s professional judgement, is of sufficient importance to merit the attention of those charged with governance.</p>

<sup>14</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 6(a)

<sup>15</sup> ISA 265, paragraph 6(b)

Extant Term in the ISAs	Change made in proposed ISA 315 (Revised)	Comments
Controls relevant to the audit / relevant controls / relevant internal control	See comments	The ISA 315 (Revised) project proposal highlighted that practitioners and others have noted that the requirement to obtain an understanding of internal controls and control activities ‘relevant to the audit’ can be difficult to apply in practice. As part of the proposed changes relating to the auditor’s understanding of the system of internal control, the Task Force has explained what ‘controls relevant to the audit’ means (see proposed changes to ISA 315 (Revised), paragraphs 13 and 20) through providing more specific guidance as to what ‘controls’ are required to be understood, as well as when the evaluation of the design of the controls and determination whether the controls have been implemented is needed. Accordingly, changes will be made where ‘relevant to the audit’ / ‘relevant control’ has been used in an extant ISA but is not referring to those specific controls that are ‘relevant to the audit’ in terms of the proposed changes to ISA 315 (Revised).
Control activities relevant to the audit	Controls relevant to the audit	In the proposed changes to ISA 315 (Revised), the term ‘control activities’ is only used as the name of a component of the system of internal control. Accordingly, any references in other ISAs to control activities (or related such as control activities relevant to the audit) will be changed accordingly, unless it is specifically referring to the component of the system of internal control.
Monitoring of controls	The entity’s process to monitor controls	The entity’s process to monitor the system of internal control is one of the components of the system of internal control - accordingly when used in the context of a component of the system of internal control, the Task Force proposes to make the change to the extant term.
Risks that require special audit consideration	Remove or replace the term	There are references in the ISAs to the ‘special audit considerations’ relating to significant risks, for example:  ISA 250 para. A12: <i>“Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they <u>require special audit consideration</u>.”</i>  Within the proposed changes to ISA 315 (Revised), the term ‘requiring special audit consideration’ is no longer

Extant Term in the ISAs	Change made in proposed ISA 315 (Revised)	Comments
		<p>used. Rather, the application material now describes what the implications for the audit are if a risk is determined to be a significant risk (see proposed changes to application material in ISA 315 (Revised), paragraph A144a). Accordingly, changes will be made as appropriate, for example:</p> <p style="padding-left: 40px;">ISA 250 para. A12: <i>“Communicating significant risks identified by the auditor helps those charged with governance understand those matters and <del>why they require special audit consideration</del>”</i> <u>the implications for the audit.</u></p>
N/A	Relevant assertion [new term]	<p>The Task Force has proposed a new concept within ISA 315 (Revised)—‘relevant assertions’ to assist with the identification and assessment of the risks of material misstatement. However, this same term has been used within extant standards to refer to assertions that are ‘relevant’ in a specific context (i.e., plain English usage of the term ‘relevant’). Accordingly, with the new defined term some of these references would be out of context, and the Task Force proposes to reconsider whether extant references to ‘relevant assertion’ remains appropriate or a change is needed (for example it may be appropriate to use ‘related’ assertion in such cases).</p>
Computer assisted audit techniques (CAATs)	Describe automated tools and techniques as appropriate	<p>As part of the ISA 315 (Revised) project plan, the Task Force has considered the modernization of ISA 315 (Revised) in relation to developments in information technology (IT). In ISA 315 (Revised), the Task Force continues to consider whether a more direct reference to data analytics is needed and will present any further changes in this regard at the June 2018 meeting. When considering standards other than ISA 315 (Revised), the Task Force has noted various references to ‘CAATs.’ The Task Force discussed whether to make further changes in the other standards but agreed that any potential changes to this term in other ISAs should be considered by the broader IAASB efforts related to Data Analytics.</p>
The auditor shall determine whether changes have occurred	The auditor shall evaluate whether such information	Extant ISA 315 (Revised) paragraph 9 permits the auditor to use information from audit procedures performed in previous audits, provided the auditor

Extant Term in the ISAs	Change made in proposed ISA 315 (Revised)	Comments
since the previous audit that may affect its relevance to the current audit.	remains relevant and reliable as audit evidence for the current audit.	<p>determines “<i>whether changes have occurred since the previous audit that may affect its relevance.</i>” This (extant) wording is utilized ad verbatim in other standards, for example: ISA 200 paragraph A30 and ISA 500 paragraph A1.</p> <p>The Task Force has proposed minor wording changes to paragraph 9 of ISA 315 (Revised), and accordingly, the Task Force proposes to change such extant references in other ISAs to the revised wording.</p>
Understanding the entity and its environment	Various aspects within this section amended in proposed changes to ISA 315 (Revised)	<p>The Task Force has proposed various amendments to ISA 315 (Revised), paragraph 11, relating to the auditor’s required understanding of the entity and its environment. As a result, various terms, utilized in the extant requirements and application material, have either been amended or restructured in the application and other explanatory material of ISA 315 (Revised), such as:</p> <ul style="list-style-type: none"> <li>➤ The entity’s ownership and governance structures;</li> <li>➤ The types of investments the entity is making and plans to make; or</li> <li>➤ The way the entity is structured and how it is financed.</li> </ul> <p>When considering other standards, these extant terms of ISA 315 (Revised) terms are sometimes utilized to describe the auditor’s responsibility in relation to risk assessment procedures, for example, ISA 550 paragraph A12 and ISA 600 paragraph A23. Accordingly, the Task Force proposes to update these terms where used elsewhere in accordance with the revisions to ISA 315 (Revised).</p>
Understanding the entity and its environment, including the entity’s internal control	Understanding the entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control	<p>In ISA 315 (Revised), an enhanced focus on the applicable financial reporting framework has been proposed, such that it has been separated and enhanced. References to the required understanding needed in ISA 315 (Revised) will reflect this enhanced matter, i.e., when referring to the ‘understanding of the entity and its environment, and the entity’s system of internal control’ this will now also include reference to the applicable financial reporting framework.</p>

Extant Term in the ISAs	Change made in proposed ISA 315 (Revised)	Comments
Identifying and assessing the risks of material misstatement through understanding the entity and its environment	Identifying and assessing the risks of material misstatement	The name of the standard has been changed, references to the name of the standard will be changed in the footnotes as appropriate.
References to particular paragraphs in ISA 315 (Revised) as appropriate	Changed as appropriate	Throughout the standards, various references (mainly in footnotes) are made to ISA 315 (Revised). These references will be updated throughout the other standards once ISA 315 (Revised) has been finalized.

Specific Changes to the Glossary of Terms

21. In addition, there are terms in the ‘Glossary of Terms’ that relate to terms used in ISA 315 (Revised) that will need to be updated, such as the components of internal control (control activities, control environment, monitoring of controls, entity’s risk assessment process and information system relevant to financial reporting). Changes are being proposed to conform with changes made to relevant descriptions in ISA 315 (Revised) and the revised COSO Framework 2013. Where specific changes have been proposed below to how a component is described that have not yet been made in the corresponding descriptions in proposed ISA 315 (Revised), these updates will be presented in the relevant paragraphs in the agenda papers for the June 2018 IAASB meeting for discussion.

Extant Glossary:	Proposed revised description in Glossary of Terms
<p><i>Control environment</i></p> <p>Includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity’s internal control and its importance in the entity. The control environment is a component of internal control.</p> <p><i>(relates to paragraph A77 of ISA 315 (Revised))</i></p>	<p><i>Control environment</i></p> <p><u>The control environment is one of the components of the entity’s system of internal control and includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity’s system of internal control and its importance in the entity. The board of directors and senior management establishes the tone at the top regarding the importance of internal control and expected standards of conduct.</u></p>
<p><i>Risk assessment process</i></p> <p>A component of internal control that is the entity’s process for identifying business risks relevant to financial reporting objectives and deciding about actions to address those risks, and the results thereof.</p>	<p><u><i>The entity’s risk assessment process</i></u></p> <p><u>The entity’s risk assessment process is a component of internal control and involves a dynamic and iterative process for identifying and analyzing risks to achieving the entity’s objectives, forming a basis for determining how risks should be managed. Management</u></p>

<p><i>(relates to paragraph A88 of ISA 315 (Revised))</i></p>	<p><u>considers possible changes in the external environment and within its own business model that may impede its ability to achieve its objectives.</u></p>
<p><i>Monitoring of controls</i> A process to assess the effectiveness of internal control performance over time. It includes assessing the design and operation of controls on a timely basis and taking necessary corrective actions modified for changes in conditions. Monitoring of controls is a component of internal control. <i>(relates to paragraph A89e of ISA 315 (Revised))</i></p>	<p><u><i>The entity's process to monitor the entity's system of internal control</i></u> <u>The entity's process to monitor its system of internal control is a component of the entity's system of internal control. It is <del>A</del> a process to assess whether the system of internal control is present and functioning effectiveness of internal control performance over time. It <del>includes</del> involves assessing the design and operation effectiveness of controls on a timely basis and taking necessary corrective actions modified for changes in conditions remedial actions. Monitoring of controls is a component of internal control. Management accomplishes monitoring of controls through ongoing activities, separate evaluation activities, or some combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities. Separate activities are conducted periodically and will vary in scope and frequency depending on the assessment of risks by the entity.</u></p>
<p><i>Information system relevant to financial reporting</i> A component of internal control that includes the financial reporting system, and consists of the procedures and records established to initiate, record, process and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities and equity.</p>	<p><u><i>The information system <del>relevant to financial reporting and communication</del></i></u> <u>The information system and communication is a component of internal control that includes the financial reporting system, and consists of the controls, and records, established to initiate, record, process and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities and equity. Communication occurs both internally and externally and provides the entity with the information needed to carry out day-to-day controls. Communication enables personnel to understand their responsibilities for controls and the importance to the achievement of the entity's objectives.</u></p>

<p><b>Control activities</b></p> <p>Those policies and procedures that help ensure that management directives are carried out. Control activities are a component of internal control.</p>	<p><b>Control activities<sup>16</sup></b></p> <p><u>Controls in the control activities component include those controls put in place by the entity to effect controls over the flows of information relating to significant classes of transactions, account balances and disclosures and the financial reporting process used to prepare the financial statements. Such controls consist of application controls and general IT controls. Regardless of whether controls are within the IT environment or manual systems, controls may have various objectives and may be applied at various organizational and functional levels. Examples of controls in the control activities component include authorizations and approvals, reconciliations, edit and validation checks, automated calculations, segregation of duties, and physical or logical controls, including those addressing safeguarding of assets.</u></p>
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### Matters for IAASB Consideration

1. The Board is asked for its views on:
  - (a) The Task Force's approach for presenting the conforming amendments in the ED (i.e., present only specific standards with an explanation for the proposed conforming amendments relating to other ISAs) (as explained in paragraphs 4 and 5 above).
  - (b) The Task Force's approach to present the conforming amendments to ISA 540 (Revised) (and related conforming amendments to ISA 200) for approval and publication at a slightly later time than the rest of the ED (as explained in paragraph 6 above).
  - (c) The conforming amendments proposed in relation to ISA 200, ISA 240 and ISA 330 (as set out in **Agenda Item 1-A** and explained in paragraphs 7–19 above).
  - (d) The other proposed conforming amendments that will be made as explained in paragraph 20 above, in particular the proposed changes to the terms 'deficiency in internal control' and 'significant deficiency in internal control' relating to ISA 265.

## II. Modernization of IT-Related Definitions

22. At the March 2018 IAASB meeting, the Board supported the inclusion in proposed ISA 315 (Revised) of the terms 'application controls in information technology' and 'general IT controls' that currently reside in the Glossary of Terms, but such support was subject to the appropriate modernization of

<sup>16</sup> The proposed revisions to the description of the 'control activities' component are consistent with what will be proposed in the application material to be discussed at the June 2018 IAASB meeting. For purposes of this Board call, the Task Force only wishes to emphasize that conforming amendments will need to be made based on these proposed amendments, and therefore these revisions are presented for information purposes only. Comments on the wording in the application material will be discussed at the IAASB meeting in June 2018.

the terms. With the assistance of an IT specialist, the Task Force has development enhancements to both of these terms as set out below.

23. In addition, as a result of its latest discussions, the Task Force is proposing that a third term, the 'IT environment,' be elevated from the Glossary to the definitions in proposed ISA 315 (Revised) and also be appropriately modernized.
24. Lastly, the Task Force reviewed the Glossary of Terms to identify any other IT-related terms that may have relevance to the auditor's procedures under proposed ISA 315 (Revised). The term 'access controls' was identified as having potential relevance. The Task Force is proposing that this definition be modernized but not be added as a defined term to the standard.

*IT Environment*

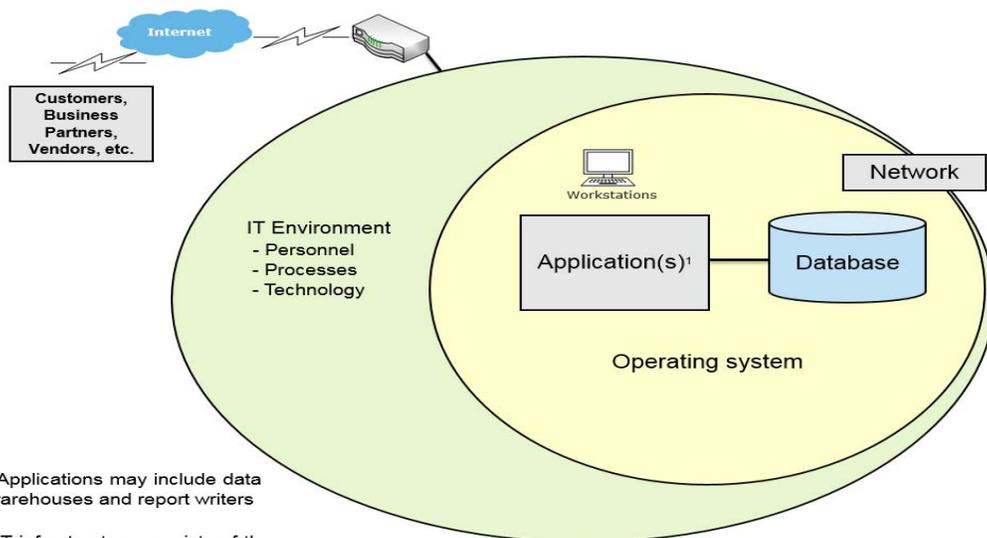
25. Paragraph 18(d) of proposed ISA 315 (Revised) requires the auditor to understand the entity's IT environment that is relevant to the information system, as follows:

18. The auditor shall obtain an understanding of the information system relevant to financial reporting, including the related business processes, through understanding:

...

(d) The entity's IT environment, including IT applications and the underlying IT infrastructure, relevant to (a) to (c) above".

26. In its recent discussions, the Task Force has learned that in practice this understanding is gained by the auditor starting from the identification of the IT applications that are used by the entity in its information system. The auditor then understands the supporting infrastructure around those IT applications.
27. The below diagram has been assembled with the assistance of the IT specialist assisting the Task Force to illustrate the various aspects and elements of an entity's IT environment and their interrelationship. This illustration presents a view of the various aspects and elements of an entity's IT environment, but there may be other ways in which this can be illustrated.



<sup>1</sup> Applications may include data warehouses and report writers

IT infrastructure consists of the network, operating system(s) and database(s)

28. Based on this diagram and supporting discussions with the IT specialist assisting the Task Force, the Task Force is of the view that the 'IT environment' should be added to the defined terms in proposed ISA 315 (Revised). This will support the requirement in paragraph 18(d) in addition to allowing for use of the term 'IT environment' throughout the standard with a consistent meaning.
29. The below definition is marked from that currently included in the Glossary of Terms. It is also proposed that supporting explanations of terms used in the definition of IT environment be provided in the application material to the definition. The Task Force believes that this approach provides a consolidated explanation of the IT environment for the purpose of ISA 315 (Revised).

**IT environment** – ~~The policies and procedures that an entity implements and the IT infrastructure (hardware, operating systems, etc.) and application software.~~ The IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this ISA:

- An IT application is a set of programs that is used in the initiation, processing, recording and reporting of transactions or information. IT applications may include data warehouses and report-writers.
- The IT infrastructure is comprised of the network, operating systems, and databases and their related hardware and software.
- The IT processes are the entity's processes to manage access to the IT environment, manage program or other changes to the IT environment and manage IT operations, which includes monitoring the IT environment.

Ax1. A report-writer is an IT application that is used to extract data from one or more sources (such as a data warehouse, a database or an IT application) and present the data in a specified format. A data warehouse is a central repository of integrated data from one or more disparate sources (such as multiple databases) from which reports may be generated or that may be used by the entity for other data analysis activities.

Ax2. A network is used to transmit data and to share information, resources and services through a common communications link. The network also typically establishes a layer of logical security (enabled through the operating system) for access to the underlying resources. The operating system is responsible for managing communications between hardware, IT applications, and other software used in the network. Databases store the data used by IT applications and may consist of many interrelated data tables. Data in databases may also be accessed directly through database management systems by IT or other personnel with database administration privileges.

#### *General IT Controls*

30. The below definition of 'general IT controls' is marked from that currently included in the Glossary of Terms. Revisions have been proposed to:
- Use the term 'controls', which is separately defined in ISA 315 (Revised).

- Modernize the definition by:
  - Using the term 'IT environment' to bring in the context of the modernized definition of IT environment proposed above.
  - Adding the important role of GITCs in supporting integrity of information.
  - Explaining that GITCs are controls over the IT processes (as described in the proposed definition of 'IT environment'), which simplifies the explanation of, and provides better context to, the role of these controls.

**General IT controls** – Policies and procedures that relate to many applications and Controls in the IT environment that support the effective functioning of application controls or the integrity of information by helping to ensure maintain the continued proper operation, as designed, of the entity's information systems. General IT controls commonly include controls over ~~data center and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development and maintenance~~ the entity's IT processes.

#### *Application Controls in Information Technology*

31. The below definition of 'application controls in information technology' is marked from that currently included in the Glossary of Terms. Revisions have been proposed to:

- Remove the reference to 'information technology' to define the term in the context that the term 'application controls' is used in the application material of ISA 315 (Revised); such usage is not confined to controls in IT.
- Use the term 'controls', which is separately defined in ISA 315 (Revised).
- Explain that such controls support the entity's information system.
- Modernize the definition to explain that application controls may rely on information or other controls, including those that maintain the integrity of information.
- Streamline the definition.

**Application controls in information technology** – Manual or automated ~~procedures~~ controls that typically operate at a business process level. Application controls can be of a preventative or detective in nature that and are designed to ensure support the integrity of the accounting records. Accordingly, application controls relate to procedures used to initiate initiation, recording, processing and reporting of transactions or other financial data information in the entity's information system. These controls help ensure that transactions occurred, are authorized, and are completely and accurately recorded and processed. Manual or automated application controls may rely on information, or other controls that maintain the integrity of information, or may rely on other controls.

#### *Access Controls*

32. The below definition of 'access controls' is marked from that currently included in the Glossary of Terms. The Task Force is proposing that the glossary definition be modernized and also simplified due to the proposed introduction of the term 'IT environment' and the revisions to the definitions of 'controls' and 'general IT controls.'

33. The Task Force is not proposing that the term ‘access controls’ be added to the defined terms in proposed ISA 315 (Revised). The term ‘access controls’ is a category of controls that is more specific than the types of controls that are described in proposed ISA 315 (Revised) (i.e., access controls are a subset of general IT controls and usage of this term in the standard is anticipated to be very limited.

~~Access controls—Procedures~~ Controls designed to restrict access to the IT applications and underlying IT infrastructure within the IT environment on-line terminal devices, programs and data. Access controls consist of “user authentication” and “user authorization.” “User authentication” typically attempts to identify a user through unique logon identifications, passwords, access cards or biometric data. “User authorization” consists of access rules to determine the access privileges ~~computer resources~~ each user may have access. ~~Specifically, such procedures are designed to prevent or detect:~~

- ~~• Unauthorized access to on-line terminal devices, programs and data;~~
- ~~• Entry of unauthorized transactions;~~
- ~~• Unauthorized changes to data files;~~
- ~~• The use of computer programs by unauthorized personnel; and~~
- ~~• The use of computer programs that have not been authorized.~~

**Matter for IAASB Consideration**

2. The Board is asked for its views on the revised and new definitions relating to:
- (a) IT environment (paragraphs 25–29);
  - (b) General IT controls (paragraph 30);
  - (c) Application controls (paragraph 31); and
  - (d) Access controls (paragraphs 32–33).

**Scalability of ISA 315 (Revised)**

*(For informational purposes)*

1. The Task Force continues to work towards making the standard scalable, enabling it to be applied to a wide variety of entities with different circumstances and complexities. During its face-to-face meeting in April 2018, the Task Force dedicated substantial time to discussions on scalability. For this purpose, the Task Force considered scalability in ISA 315 (Revised) based on detailed recommendations from a Task Force member who is a member of the International Federation of Accountants SMP Committee. Based on its deliberations, the Task Force has proposed further changes to the application and other explanatory material as it seeks to further enhance the scalability of the standard which will be presented for discussion at the June 2018 IAASB meeting.
2. Firstly, the Task Force will propose to present these matters as being relevant to “smaller or less complex entities” recognizing that it’s not only size that drives scalability needs. Further, proposed editorial changes have been considered with illustrations to convey different complexities and sizes. In addition, the placement of matters related to scalability (i.e., for those entities that are smaller or less complex) have been advanced to the start of some sections so that auditors in a smaller or less complex environment may consider the material that follows in context.
3. The Task Force continues to identify further potential areas of the application material where scalability might be included, as it relates to an entity’s use of IT and the effect on general IT controls relevant to the audit. The Task Force will also continue to consider implementation guidance as appropriate.

## Next Steps in Enhancing the IT-Related Guidance

*(For informational purposes)*

1. At the March 2018 meeting, the Board was supportive of the Task Force continuing to enhance the application material to better support the auditor's required understanding of the IT environment, the risks arising from the entity's use of IT and the identification of general IT controls relevant to the audit. In particular, the Board asked that further consideration be given to clarifying whether general IT controls are expected to be relevant to the audit in all circumstances or, if not, how the auditor would determine the extent to which general IT controls are relevant for a particular audit.
2. In its recent Task Force discussions, the Task Force has further refined its thinking on the auditor's approach to understanding IT and determining its relevance to the audit. With the assistance of an IT specialist, the Task Force has developed a clarified approach to be implemented in the updated draft for the discussion at the June 2018 Board meeting. This approach can be summarized as follows:
  - The auditor understands the IT environment relevant to the information system as required by paragraph 18(d). The introduction of the term 'IT environment' as proposed in this paper provides greater clarity on the various aspect of the IT environment to be understood.
  - From the understanding gathered under paragraph 18(d), the Task Force is of the view that the auditor uses the four criteria (currently included in paragraph 21A of ISA 315 (Revised)) to determine which IT applications and other aspects of the IT environment are 'relevant to the audit.' The Task Force plans to clarify in the requirement in paragraph 21 of ISA 315 (Revised) the need for the auditor to consider these criteria in the context of determining the IT applications relevant to the audit. The Task Force also plans to provide supporting application material to further explain each of these criteria. As a reminder these criteria include the auditor's consideration of:
    - (a) Automated controls that management is relying on and that the auditor has determined to be relevant to the audit;
    - (b) How the entity maintains the integrity of information stored and processed in the information system that relates to significant classes of transactions, account balances or disclosures;
    - (c) System-generated reports on which the auditor intends to rely on without directly testing the inputs and outputs of such reports; and
    - (d) Risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.
  - For the IT applications and other aspects of the IT environment determined to be 'relevant to the audit,' the Task Force is of the view that the auditor identifies the risks arising from the entity's use of IT (currently in paragraph 21 of ISA 315 (Revised)) and identifies general IT controls that address those risks as relevant to the audit (paragraph 21A of ISA 315 (Revised)). The application material to these requirements is planned to be enhanced to explain the possible risks and controls that the auditor may consider, as well as explaining that the extent

to which GITCs are relevant to the audit will vary based on the circumstances of the engagement and planned audit approach or strategy.

3. The Task Force believes that this approach will assist the auditor's decision-making in determining the extent of general IT controls relevant to the audit. In particular, the Task Force is of the view that it is not necessary for the auditor to identify risks arising from the entity's use of IT or general IT controls relevant to the audit unless the related IT applications are determined to be relevant to the audit (taking into account the criteria above).
4. In circumstances when an entity's IT environment consists only of commercial software for which the entity does not have access to the underlying source code (which may be the case for many smaller, less complex entities), the auditor may determine that none of the entity's IT applications meet the criteria listed above for different reasons, including that the auditor plans to substantively test all reports and other information produced by the entity's information system that are used as audit evidence. In contrast, for larger, more complex entities or for audits where the auditor plans to take the approach of testing the operating effectiveness of automated controls, the auditor may determine that there are several IT applications relevant to the audit. This may then drive a greater extent of general IT controls being identified as relevant to the audit.
5. The Task Force plans to revise and enhance proposed ISA 315 (Revised) to incorporate the above approach in the draft for discussion at the June 2018 Board meeting. This will include some clarifications to the requirements in paragraphs 21 and 21A, but mainly will involve clarifying enhancements to the application material. In addition, the Task Force plans to consider conforming amendments to paragraphs A29 to A31 of ISA 330, which address testing general IT controls, in light of the above approach.