ISA 315 (Revised)¹—Summary of Respondents’ Comments

This Agenda Item provides a summary of stakeholder views in response to certain matters in ED-315² that have not yet been presented to the Board. Task Force views and actions are either explained in this Agenda Item or within Agenda Item 2 (relevant paragraph references are provided).

Definitions

(Excluding IT – see Agenda Item 2 paragraphs 41-43, and excluding definitions considered during the March 2019 IAASB meeting)

(See NVivo Reports 3A, 4A, 6A and Excel Summaries 3B, 4B and 6B from the March 2019 IAASB meeting)

Monitoring Group (MG) Responses

1. One MG member noted that although compliance with laws and regulations is inherently part of the definition of the system of internal control; the definition does not expressly cover or include compliance with prudential regulations. It was therefore suggested to expand the definition and therefore include the understanding of applicable prudential laws and regulations when performing risk assessment procedures.

2. Another MG member expressed concern with the wording ‘statements may be documented, explicitly stated in communications, or implied through actions and decisions,’ as included in the definition of ‘controls.’ It was noted that this may impose a responsibility on the auditor to understand controls beyond those that are documented by the company, which may not be feasible or appropriate.

Other Respondents’ Comments

3. One respondent argued that the term ‘assertion’ may have a different meaning depending on the context that it is being used. For example, assertions may be explicit and implicit to the representations in the financial statements, or alternatively, it may refer to the tools used by auditors to identify and assess risks of material misstatement. The respondent suggested that the definition of ‘assertions’ is changed to clarify the intended meaning of the term.

4. Although respondents welcomed the acknowledgement that ‘controls’ may be ‘implied through actions and decisions,’ and therefore not necessarily documented, concern was expressed that the definition may have unintended consequences. Concern was expressed as to the required work effort in identifying such controls, as well the extent of the related documentation requirements.

Task Force Views

5. In regard to compliance with prudential regulations, the entity’s compliance with laws and regulations is addressed in ISA 250.³ In ED-315, the auditor’s understanding of the entity and its environment is required to include understanding relevant industry, regulatory and other external factors. A change was made to

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

² Proposed ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement

³ ISA 250 (Revised), Consideration of Laws and Regulations in an Audit of Financial Statements

Prepared by: Bev Bahlmann and Phil Minnaar (June 2019)
paragraph A66 to include prudential regulations as an example of a regulatory framework that may be applicable. Clarification has also been made to distinguish management's assertions.

6. The Task Force intends to clarify in implementation guidance how the auditor considers policies and procedures that may be less formalized, so as to communicate the intent of the work effort in relation to these. For example, these controls may be present in less complex entities in particular. The view of the Task Force is that understanding such controls, when required, can be performed through a combination of inquiry and observation.

Public Interest Issues

Summary of Responses—Public Interest Issues

(See NVivo Report 1A and Excel Summary 1B)

7. The following sets out the matters raised by respondents in response to Question 1(b) in ED-315 whether the public interest issues outlined in the explanatory memorandum had been addressed:
   • Concern whether the revised standard is scalable.
   • Whether there is sufficient guidance addressing the use of automated tools and techniques.
   • There should be a clearer delineation between ISA 315 (Revised) and ISA 240.
   • The term 'public interest' should be explicitly addressed within the standard.
   • The importance of keeping the standard principles-based.

8. Two respondents also noted that by addressing the concerns raised in response to individual questions would help the IAASB achieve its objectives of making the revisions.

Task Force Views

9. The Task Force continues to consider the scalability of the standard, as well as how best to present matters relating to automated tools and techniques (see Agenda Item 2).

10. The Task Force has again discussed explicit references to public interest within the standard, but continues to have the view that, consistent with the other ISAs and prior direction from the Board on this matter, explicit reference should not be added to the standard. However, the Task Force continues to consider how best to present those matters that have been noted to be in the public interest, for example by explaining, possibly in the introductory paragraphs, the linkage of an effective risk assessment to the audit’s capability to serve the public interest.

11. The IAASB has agreed on a way forward with regard to how the respondents’ comments have been addressed, including providing these summaries of the comments (such as in this Agenda Item) presented in the NVivo reports and excel summaries.

Overarching Comments not Addressed Elsewhere

Summary of Responses—Overarching Comments not Covered Elsewhere

(See NVivo Report 2A and Excel Summary 2B)

12. In working through completeness of having addressed all comments made by respondents, a number of overarching comments made in the introductory sections of respondents’ letters to ED-315 have been analyzed to ensure that any additional issues have been addressed.
13. Excel summary 2B sets out the matters that were noted that have not been specifically addressed in March 2019 or in Agenda Item 2 for the June 2019 IAASB meeting. The majority of the comments noted have been made by individual stakeholders, and after further consideration by the Task Force, no further action is required.

14. The concern relating to the introduction of the PCAOB concepts into ISAs was also considered by the Task Force. The newly introduced concepts have been broadly supported by global respondents to ED-315, with further amendments or enhancements to address specific issues raised with regard to these being proposed in response to specific issues or concerns raised. The Task Force continues to have the view that these new concepts help with the risk assessment process and therefore no further changes are proposed (except as previously noted).

Professional Skepticism

Summary of Responses—Professional Skepticism

(See NVivo Report 3A and Excel Summary 3B)

Monitoring Group Responses

15. In relation to the importance of exercising professional skepticism by the auditor, all of the MG members who responded to ED-315 suggested that the standard should be further enhanced for the auditor’s exercise of professional skepticism during the risk assessment process. In particular, the IAASB was encouraged to give more prominence to the application of professional skepticism within the requirements, taking into account that professional skepticism was only explicitly recognized in the introductory paragraphs and application material of ED–315. As a suggestion, reference was made to how the consideration of contradictory and corroborative evidence has been incorporated into the requirements of the recently approved ISA 540 (Revised).

16. One MG member proposed that the standard contain an explicit requirement for the documentation of the auditor’s application of professional skepticism, rather than relying on the reference to overall documentation requirements in accordance with ISA 230.

Other Respondents’ Comments

17. Although broadly supportive of the proposals in ED–315, respondents have suggested that further enhancements throughout the standard in relation to the emphasis or importance of professional skepticism would be beneficial. In particular, respondents have

- Questioned whether the standard can effectively address the behaviors needed for the effective application of professional skepticism.
- Expressed concern that the complexity of ED–315 may impair the auditor’s ability to effectively exercise professional skepticism.

A number of editorial suggestions were also noted.

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4 ISA 540, Auditing Accounting Estimates and Related Disclosures, paragraphs 18 and 34
5 ISA 230, Audit Documentation
Task Force Views

18. The Task Force has proposed two new requirements to further emphasize the importance of professional skepticism and enhanced the application material accordingly – see paragraphs 29 and 30 of Agenda Item 2 for details about the changes made.

19. In responding to the suggestion to have an explicit requirement to document the application of professional skepticism by the auditor, the Task Force considered existing guidance as included in the application material of ISA 230 paragraph A7. Changes in mark-up represent conforming amendments arising from the approval of ISA 540 (Revised).

A7. In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:

- For example, there may be no single way in which the auditor’s professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor’s exercise of professional skepticism in accordance with the ISAs. For example, in relation to accounting estimates, when the audit evidence obtained includes evidence that both corroborates and contradicts management’s assertions, documenting how the auditor evaluated that evidence, including the professional judgments made in forming a conclusion as to the sufficiency and appropriateness of the audit evidence obtained. Such evidence may include specific procedures performed to corroborate management’s responses to the auditor’s inquiries.

20. Notwithstanding existing guidance in ISA 230, the documentation requirements of ED-315 also require the auditor to document significant judgments made in identifying and assessing the risks of material misstatement. Accordingly, it is the view of the Task Force that an explicit requirement to document the auditor’s application of professional skepticism in ISA 315 (Revised) is not needed.

Inherent Risk Factors (including Fraud)

Summary of Responses—Inherent Risk Factors (IRFs)

(See NVivo Report 4A and Excel Summary 4B)

Monitoring Group Responses

21. The MG members strongly supported the introduction of the IRFs.

22. One MG member encouraged the IAASB to carefully consider how the risk assessments required by ED-315 and ISA 240 can be best performed in a coordinated manner to avoid either assessment becoming separate compliance exercises. Specifically, the MG member requested the IAASB to consider how the standard could facilitate a better integrated evaluation of the fraud risk factors outlined in ISA 240 and the IRFs in ED–315.

23. A concern was expressed that the inherent risk factors are discussed in the definitions but are not prominent enough in the requirements of ED–315.

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6 ISA 240, The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements
Other Respondents’ Comments

24. Although the introduction of the inherent risk factors was broadly supported, respondents expressed concern that:
   - Some of the IRFs may have the same meaning or overlap, e.g., subjectivity and uncertainty.
   - The reference to ‘such factors may be quantitative’ in the definition, as this may be interpreted to mean that all material account balances or classes of transactions could be identified as risks of material misstatement.
   - It was not clear about how the auditors’ considerations about the IRFs should be documented.

25. Respondents also asked for further clarification in relation to the meaning of ‘taking into account the inherent risk factors,’ when considering the IRFs.

26. Respondents expressed mixed views about the explicit inclusion of the consideration of ‘fraud’ in the definition of the IRFs. Those not in favor of the inclusion of ‘fraud’ noted:
   - ISA 240 sets out fraud risk factors for the auditor’s considerations, and already requires the auditor to identify and assess the risks of material misstatement due to fraud at the financial statement level and at the assertion level for classes or transactions, account balances and disclosures.
   - That the susceptibility to fraud may arise as a result of a weak control environment or deficiencies in internal control and is therefore not necessarily an inherent risk per definition.

In contrast, others still had the view that fraud should be more explicitly recognized in the IRFs and therefore asked for further clarity on how the inherent risk factors interact with the fraud risk factors in ISA 240.

Task Force Views—Proposed Changes to Inherent Risk Factors

27. The Task Force recognizes that the consideration about whether ‘fraud’ should be included as an IRF was a subject of much discussion by the Board leading up to the issuance of the ED. The Task Force further acknowledges that the consideration of fraud is critical from a public interest perspective. Nonetheless, the IRFs are intended to represent characteristics of events and conditions that affect susceptibility to misstatement before consideration of controls, whereas fraud risk factors relate to both inherent risk and control risk. Accordingly, on balance, the Task Force agreed to propose a change to the inherent risk factor in ED-315 that addressed fraud. In considering the change (i.e., to remove an explicit reference to fraud), the Task Force considered how fraud has been addressed in ISA 240: fraudulent financial reporting or misappropriation of assets. The Task Force had the view that susceptibility to management bias includes susceptibility to fraudulent financial reporting. However, it was noted that susceptibility to management bias does not include, misappropriation of assets), and therefore agreed that this should be added because the nature of assets is relevant to assessing inherent risk.

Inherent Risk Factors – Characteristics of events or conditions that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity,
subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or fraud misappropriation of assets.

28. Paragraph 26 in Agenda Item 2 also explains other considerations and changes of the Task Force in relation to the IRFs.

29. The Task Force has again considered whether further reference to the inherent risk factors within the requirements is needed, but continues to have the view that the reference when understanding the entity, as well as when assessing the risks of material misstatement, remains appropriate. In regard to the inclusion of quantitative aspects within the IRFs, the Task Force is of a view that is important to keep the quantitative aspects as they are relevant to the auditor’s consideration of the susceptibility to misstatement of assertions about classes of transactions, account balances and disclosures.

30. Consistent with the approach to the redrafting of the application material, the specific guidance within the application material describing each IRF in more detail has now been moved to a new Appendix (see Appendix 2 in Agenda item 2-D) relating to the IRFs.

31. Various changes and enhancements have been made within the application material and Appendix 2 relating to further clarifications relating to the IRFs.

Information Technology (IT)

Summary of Responses—IT

(See NVivo Report 5A and Excel Summary 5B)

Monitoring Group Responses

32. MG members expressed strong support for the enhancements made to IT.

33. One MG member suggested that the standard could be further enhanced in relation to risks arising from the outsourcing of IT services, taking into account factors such as the location, storage and management of data by third parties.

Other Respondents’ Comments

34. Respondents were broadly supportive of the introduction of the new IT-related concepts, definitions and guidance. However, there were respondents that expressed concern about the volume of material that was added and suggested that further consideration be given to simplifying the material or moving some of the new material to an Appendix or to guidance outside of the standard. It was also noted that there was inconsistent use of certain terminology.

35. Various respondents questioned the definition of ‘application controls,’ with particular reference to application material that explains that such controls could be manual or automated. Although some have the view that application controls include both manual and automated, the concern was expressed that many auditors presume that application controls relate to automated controls only. Other minor points were notes relating to the IT-related definitions.

36. Although supportive of the enhancements to the standard, respondents asked for additional guidance in relation to:
   - Outsourcing of data and IT.
- Risks arising from IT\(^8\) —including the nature of such risks and examples of the circumstances when the auditor is required to identify or evaluate GITCs.
- When GITCs\(^9\) are relevant to the audit.
- When IT applications are relevant to the audit, \(^10\) or alternatively, when are IT applications not relevant to the audit.
- How the understanding of the IT environment helps the auditor to identify risks of material misstatement.
- Emerging technologies and cybersecurity.

37. Various respondents also noted the need for additional guidance in relation to off-the-shelf or commercial software. Specific concerns and points raised include:

- The required work effort in case of a simple and low-risk IT environment. Respondents noting these concerns suggested that a conditional requirement is necessary to introduce a clear exception for entities using off-the-shelf software packages (e.g., introducing a minimum requirement to only assess the modifications or updates to software packages or modification to standard or default IT functionalities).
- The lack of clarity when the auditor may conclude that there are no application controls relevant to the audit.
- An acknowledgement that while the use of off-the-shelf packages does indeed eliminate some risks, other basic controls may be important, including those relating to the physical security of data, and simple controls over the customization of reports (such as the reporting parameters for receivables listings).

**Task Force Views— Proposed Changes to IT**

*Definitions*

38. Paragraphs 41 to 43 of Agenda Item 2 set out the Task Force’s views and proposed changes in relation to the IT-related definitions.

*Requirements, Application Material and Appendices*

39. Paragraphs 44 to 49 of Agenda Item 2 sets out the Task Force’s considerations and changes in relation to IT, including moving some of the application material to and Appendix.

40. As noted in Agenda Item 2-E further consideration will be given to whether, and in what form, further guidance is developed in relation to less complex entities.

**Financial Statement Level Risk**

*Summary of Responses—FS Level Risk*

(See NVivo Report 6A and Excel Summary 6B)

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\(^8\) ED–315, paragraph 41(a)  
\(^9\) ED–315, paragraph 41(b)  
\(^10\) ED–315, paragraph 40
Monitoring Group Responses

41. MG members have not provided any comments on the question included in the explanatory memorandum in relation to the auditor’s assessment of risks of material misstatement at the financial statement level.

Other Respondents’ Comments

42. Although broad support was expressed for the enhancements made, there were respondents who expressed concern that the additional guidance was superfluous or merely repeating the requirement. It was also noted by a respondent that the guidance was complex and that there was inconsistent use of terminology.

43. Respondents supporting the enhancements noted areas where enhancements were needed, including:
   - Additional guidance relating to the assessment of risks at the financial statement level.
   - Clarifying whether a risk at the financial statement level could be a significant risk.
   - Further explaining the relationship between risks of material misstatement at the financial statement level and risks of material misstatement at the assertion level.
   - Clarifying what is meant by the requirement to determine ‘the degree to which’ financial statement level risks affect the assessment of risks of material misstatement at the assertion level. A concern was expressed that the requirement to ‘determine’ an affect implies a quantifiable judgement, which may be unrealistic and may create an onerous and impractical documentation expectation.

44. A respondent also called for defining “financial statement level.”

Task Force Views

45. The Task Force has reconsidered the operability of the requirement to identify and assess the risks of material misstatement at the financial statement level, and the interaction with the assessment of the risks of material misstatement at the assertion level. In doing so, the Task Force agreed to clarify the link to the risks at the assertion level by rather considering ‘whether’ risks at the financial statement affected the risks of material misstatement at the assertion level.

46. The Task Force has also enhanced the application material to better link the understanding obtained of the ‘indirect’ components of the entity’s system of internal control to the assessment of risks of material misstatement at the financial statement level.

47. The Task Force discussed but agreed that there was no need to define financial statement level as it is appropriately described in ISA 200.11

Risks for Which Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence

Summary of Responses—Risks for Which Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence

(See NVivo Report 7A and Excel Summary 7B)

11 ISA 200, paragraph A37
Monitoring Group Responses

48. One MG member suggested that the criteria (noted in paragraph 30 of extant ISA 315 (Revised)), when such risks are applicable, should remain in requirements consistent with extant ISA 315 (Revised).

Other Respondents’ Comments

49. Two respondents supported the view of the MG member, noting that it is helpful to include the criteria in the requirement when ‘risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence’ are applicable.

50. Although broad support was expressed for the enhancements made, respondents noted the concept could be better explained in light of evolving automation and technology. It was also suggested that the placement of this paragraph be further considered.

51. A few respondents asked for further guidance when the auditor would expect to have risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, as well as for in circumstance where the auditor identify ‘risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence,’ however, the controls do not operate effectively.

Task Force Views

52. The Task Force has further considered the need for clarification related to those situations where substantive procedures alone cannot provide sufficient appropriate audit evidence. The Task Force has agreed that it is important to explain ‘why’ these are required to be identified separately, and explanatory paragraph has been added (see paragraph A231a in Agenda Item 2-C).

53. The Task Force has also reorganized the relevant application material, has added an example and has moved the requirement to before the auditor assesses control risk, which would be more logical because the auditor is required to test controls related to these risks and the auditor’s intentions to rely on controls drives the assessment of control risk.

Documentation

Summary of Responses—Documentation

(See NVivo Report 8A and Excel Summary 8B)

54. Although there was not a specific question on documentation, a number of comments were raised specifically relating to documentation, in particular a call for more specificity in the requirements.

Monitoring Group Responses

55. MG members noted the need for specific documentation requirements in relation to:

1. How the auditor applied professional skepticism.
2. How risks have assessed on the spectrum of risk.

Other Respondents’ Comments

56. Four respondent’s noted concern about the general level of documentation required in ED-315, noting it would be excessive particularly for less complex entities.
57. Other respondents also called for more specificity in the requirements for documenting:
   1. The factors considered when deciding that an entity is a less complex entity.
   2. The new stand-back requirement.
   3. Audit procedures using automated tools and techniques.
   4. The assessment of inherent risk on the spectrum of inherent risk.

58. There were also more calls for guidance about the nature and extent of documentation relating to:
   1. The use of automated tools and techniques when performing audit procedures.
   2. What ‘significant judgments’ are required to be documented.
   3. The auditor’s consideration of the IRFs.
   4. The auditor’s understanding of the entity’s system of internal control, including the required evaluations.
   5. The new stand-back requirement.
   6. The assessment of inherent risk on the spectrum of inherent risk, including assessing the likelihood and magnitude of the identified risk.
   7. The auditor’s determination of the ‘degree to which’ the financial statement level risks affect the assessment of the risk of material misstatement at the assertion level.
   8. Professional skepticism.
   9. The meaning of ‘key elements’ of the auditor’s understanding in paragraph 54(b) of ED-315.

59. There was also a call for guidance on when the auditor needed to document what had not been done (for example if a requirement is not applicable).

60. It was noted by respondents that further clarification was needed to link how much documentation is needed to the requirement for obtaining a ‘sufficient and appropriate evidence” in paragraph 17 of ED-315.

Task Force Views

61. The Task Force considered the call for additional specificity in the requirements but continues to be of the view that the current requirements in ED-315 are adequate taking into account the requirement in ISA 230 to document ‘significant matters arising during the audit,”12 and the need to maintain principles-based requirements.

62. The Task Force has enhanced the application material to support the principles-based requirements, emphasizing that the nature and extent of documentation is influenced by the nature, size and complexity of the entity (thereby also emphasizing the scalability of the standard to entities of all sizes and complexities). However, the Task Force also acknowledges that further guidance (in the form of implementation materials) may still be needed and will further consider specific guidance on documentation based on feedback received at this June 2019 IAASB meeting.

12 ISA 230, Audit Documentation, paragraph 8(c)