Responses to ED–315¹
Overarching Comments by Respondents (Not included elsewhere)
NVivo Report 2A
(FOR REFERENCE)

01. Basel

Although the Committee is aware of the IAASB’s current stance toward auditing standards as being applicable for all audit engagements, the Committee holds the view that auditing standards should also be appropriate for audits of complex entities including, in particular, audits of entities in the financial industry (notably banks). The Committee encourages the IAASB to ensure that new standards and revisions to existing standards touch upon the risks of material misstatement arising in audits of complex entities, including appropriate consideration of underlying internal systems and procedures. The Committee would prefer this material to be included in the “requirements” section for auditing standards. However, if the IAASB were to decide that it would be best to address industry-specific requirements and guidance outside the standards, for example in an International Auditing Practice Note (IAPN) or other material, the Committee urges the IAASB to take up such work as soon as possible.

02. CEAOB

We suggest that the “definition” section is reviewed to ensure that all concepts are clearly linked with the requirements of the standard. For example – the “spectrum of inherent risks” is mentioned in the definition section to explain what a “significant risk” is (in paragraph 16.k), but does not appear throughout the rest of the standard. We would expect a further requirement in the standard for the auditor to assess where the identified risks are in this spectrum, for the purpose of determining “significant risks” (mentioned in paragraph 49).

03 CPAB

In Canada CPAB is focused on ensuring a consistent level of audit quality across the audit of all reporting issuers in Canada. We are concerned that an approach to have a scaled down risk assessment process for certain audits could lead to a significant difference in the audit quality between different size entities having a negative impact on the public interest.

At a minimum, we suggest a clarification be added to the final standard that a scaled back approach to risk assessment would not be applicable to listed companies and other entities that have a significant public interest, regardless of whether the entity is not considered to be complex.

04. IAASA

We note that revision of ISA 330 is not part of the IAASB work plan. We believe it is vital that ISA 330 is reviewed in light of amendments to ISA 315 given the linkages between the two standards. We note that conforming amendments are proposed but do not feel these sufficiently address new concepts including ‘spectrum of risk’ and ‘inherent risk factors’.

05. IAIS

Considering the significance of changes made to ISA 315 in the ED, the IAIS believes that it is important to review ISA 330 with the objective to take into account all the changes introduced in proposed ISA 315 as well as the current developments in the auditing techniques.

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¹ Exposure Draft International Standard on Auditing 315, Identifying and Assessing Risks of Material Misstatement
15. IDW

We have become increasingly concerned about some developments in the standard setting process at the IAASB and our responses to the questions posed in the Explanatory Memorandum reflect those concerns. We recall that the original audit risk project (which started as a project among major standard setters) commenced in the mid-1990s and was completed around 2004; further refinement took place through the Clarity Project by the end of 2008. This represents a time period of about nine years followed by another four years. The fact-finding for the current project effectively commenced in March 2016, but the project itself commenced its work shortly after September 2016 and has already issued an exposure draft with fundamental changes in mid-2018. We recognize that the world is becoming faster-paced, but we also believe that the prime indicator of robust standards is their ability to stand the test of time despite the faster pace of disruptive change. To draft such robust standards, more time, rather than haste, is needed.

We agree that a revision of ISA 315 is needed to address the issues arising from implementation monitoring and inspections and that this project be undertaken.

However, our analysis of the draft indicates to us that not enough time has been spent on fundamental issues resulting from the interplay between the definitions and the requirements, and that these will lead to a considerable increase in work effort on audits and a more bureaucratic approach to audits; we are convinced that the increase in work effort will not be worth the increase in assurance obtained.

These changes will also be detrimental to the scalability of audits – particularly for audits of smaller and less complex entities. The fact that a few particular national audit regulators (regardless of whether or not they use the ISAs) that have less interest in the broad application of the standards to all kinds of audits worldwide desire certain matters in standards in a short period of time is – from our point view – not a reason for an international auditing standard setter to allow itself to be put under time or technical pressure.

The draft includes many useful improvements to risk assessment, including to the understanding of the entity and its environment, the introduction of the inherent risk factors, the clarification of the meaning of a significant risk and how it is determined, the auditor’s consideration of the components of internal control, and the consideration of IT in risk assessment. It is unfortunate that these significant improvements are, from our point view, overshadowed by some of the fundamental changes that we regard to be disproportionate.

We are also concerned that the draft is not understandable: we are convinced that due to the subtlety of the terminology used and process described, outside a small group of experts in standard setting or large network methodologies, few practicing auditors – especially not those SMPs that audit financial statements of small and less complex entities – will be able to understand and apply the standard as drafted. We also believe that the length of the draft will be a barrier to acceptability: much of the application material appears to read like a textbook or audit manual on risk assessment, rather than pithy, well-directed guidance needed to understand the requirements.

Overall, we hope that the IAASB will take our comments in the spirit in which they are being given, which is to help the IAASB to continue to issue auditing standards of global application for all kinds and sizes of audits by addressing those matters of concern in relation to this draft.

27. Grant Thornton International

Overall, we are concerned that the scope of the proposed amendments to ISA 315 (Revised) are far in excess of those originally contemplated by the project scope, which included, amongst others, the objectives of:
Establishing more robust requirements and appropriately detailed guidance to drive auditors to perform appropriate risk assessment procedures in a manner commensurate with the size and nature of the entity; and

Determining whether and how ISA 315 (Revised), in its organization and structure can be modified to promote a more effective risk assessment.

We are of the view that the proposed amendments are unlikely to lead to significant positive change in behaviors, and when considered in conjunction with the flowcharts, would lead auditors down a path that is reminiscent of adhering to an audit methodology, rather than a principles-based standard that can be universally adopted. Consequently, we believe that audit quality may be negatively impacted.

30. PwC International

Reference 1:

We note the acknowledgement by the Board that there was no intent to change the extant risk assessment model. However, in our view, the ED represents, in certain aspects, quite a fundamental revision of the model. We have concerns that the extent and clarity of the proposed changes to the risk assessment requirements, and the totality of the proposed revisions, risk confusion that may lead to increasing, rather than reducing, the current inconsistency in practice.

The complexity of the proposed requirements in the ED, and lack of clarity of some of the concepts, together with the overall length of the standard, also, in our view, raise questions as to whether the proposed revision can be applied effectively and efficiently to smaller and less complex audits. Given the critical nature of this standard in underpinning the entire range of audits, if clarity and scalability are not successfully addressed this poses a risk to adoption by jurisdictions and of national standard setters seeking alternative solutions to the ISAs. We comment further on this issue below.

For these reasons, we do not support the ED in its current form.

We believe the issues identified in relation to the extant ISA can best be addressed through structural changes to the extant requirements, together with targeted refinements to requirements and the provision of additional guidance in those areas identified as requiring clarification. This would bring the needed clarity to strengthen the extant ISA and support consistent and robust risk assessments in performing high quality audits.

Our recommendations for appropriate changes that address the project scope

Given our concerns about the proposed revisions, we felt it was important to invest the time to articulate alternative suggestions that would address our concerns while achieving the objectives behind the revision of ISA 315.

Appendix 2 sets out an initial outline of what we believe to be a more helpful approach and structure for the requirements of the standard. In developing this approach, our thinking has been framed with the following objectives in mind:

- Building a logical and intuitive structure that appropriately incorporates new concepts that clarify, and thereby drive consistency in, the auditor’s work effort;
- Directly addressing concerns about scalability by making clear the extent of the understanding of the entity’s system of internal control relevant to financial reporting that is appropriate to support the auditor’s assessment of inherent risks, and the further understanding that is needed when planning to obtain audit evidence from testing controls; and
• Clarifying existing concepts identified as being misunderstood in practice or applied inconsistently, based on the ISA post-implementation review.

Our suggestions more directly link what the auditor needs to understand regarding the entity’s system of internal control to support separately the assessments of inherent risk and control risk. We believe more explicitly setting out the required understanding of internal control to support each of these assessments presents an opportunity to deliver the much called for clarity for audits of smaller and less complex entities regarding the nature and extent of understanding that, as a minimum, is needed when the auditor does not intend to obtain audit evidence from evaluating the design and testing the operating effectiveness of controls. We would be happy to work with the Board’s Task Force to explain our thinking and further develop this approach if this is considered appropriate.

Our suggestions also seek to minimise the introduction of unnecessary new definitions and concepts. The ED’s proposed approach appears to be drawing on concepts included within the PCAOB risk assessment model, yet trying to fit these into the existing framework of an ISA audit. This may cause confusion. We believe our suggestions achieve the objective of the revision without needing to introduce new concepts.

In other areas, we believe the proposed changes do not go far enough in eliminating confusion that exists in the extant standard around certain critical key concepts. In particular, we believe there is an opportunity to clarify how the concept of “control risk” is used in a financial statement audit by reframing the application of the audit risk equation to better reflect how auditors apply it in gathering audit evidence.

39. Accountancy Europe

We also note that ED-315 introduces PCAOB terminology that is inappropriate in an ISA environment. While the notion of ‘reasonable possibility’ is helpful in plain English in explaining the level of likelihood to take into account when identifying relevant assertions and risks of material misstatement, a different term should be used because of its connotations with standards issued by the PCAOB. In addition, associating this notion with the wording ‘more than remote’ is confusing in an ISA environment. It implies a lower threshold than the ISA term ‘acceptably low level’ and will confuse practitioners.

A further area of concern is the introduction of the so-called “drill down”. Whilst a deeper drill down may be appropriate for complex audits, it should not be systematically the case for global application.

44. EFAA

We note the infusion of concepts from the PCAOB’s auditing standards. While international harmonisation is generally welcome, we question whether introducing such concepts, designed for large listed entities in an advanced Western economy, lend themselves to a standard used in the audits of SMEs around the world. The PCAOB did not have non-complex, small and scalability in mind when they developed them. We therefore urge caution in adopting such concepts for all audits.

56. Institute of Internal Auditors

No discussion of ISA 315 can ignore its close association to ISA 610. The latter includes direction for evaluating the extent to which external audit should rely on the work of internal audit. This includes taking account of internal audit’s objectivity, competency, approach and quality control.

Simply put, external auditors can and should rely on the work of internal audit when the internal audit function is independent, appropriately resourced, and follows The IIA’s International Standards for the Professional Practice of Internal Auditing. Therefore, the sole test of the reliability of internal audit’s work should focus on conformance to the Standards, including assessing the function’s status within the organization.
The fundamental purpose of the Standards is to provide practitioners with guidance and direction for successfully performing professional internal auditing. The Standards, part of the International Professional Practices Framework (IPPF), includes attribute standards that address both individual and organizational **independence** and **objectivity** (Standards 1100, 1110, 1112, 1120, 1130), **proficiency** and **due professional care** (Standards 1200, 1210, 1220), and **quality assurance** (Standards 1300, 1310, 1311, 1312, 1320, 1321, 1322).

Additionally, The IIA’s performance standards further direct practitioners on managing the internal audit activity, as well as planning and executing engagements. Implementation guidance provides additional direction on applying the Standards. This comprehensive, tested, and proven set of professional canons provides what practitioners need to conduct high-quality internal audit and should be the only measure of internal audit independence, objectivity, competency, and quality.

The IIA urges IAASB to reconsider its direction to external auditors regarding reliance on the work of internal audit by specifically focusing on three areas:

1. Conformance to IIA Standards is fundamental to internal audit competency and quality and, therefore, should be the only barometer of whether internal audit can be relied on. Otherwise, the test is at best subjective and at worst runs the risk of a perception of self-interest.

2. Recognizing audit committee oversight relating to internal and external audit operations is integral to understanding internal audit’s status in the organization.

3. Reviewing the possibility that ISA 315 (revised) and ISA 610 (revised), as currently constituted, could create a perception of self-interest bias by the external auditor in the public’s view.

These three points are further examined below.

**Conformance to IIA Standards**

The work of external audit — providing assurance on the accuracy of financial reporting — is a complex operation. Adding to the challenge, external auditors face increasing pressure from boards, regulators and activist investors to identify material weaknesses in internal controls.

A generally accepted definition of material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Identifying such weaknesses requires a thorough and sophisticated understanding of internal control within the organization. Internal audit’s place as an independent and ongoing assurance provider on internal controls across the organization makes it the default expert. In its limited and periodic review role, external audit cannot be expected to have as comprehensive an understanding of internal control.

Conformance to IIA Standards, as well as other components of the IPPF, endorses that the function is independent, is operating to a strict code of ethics and defined professional standards, undergoes periodic internal and external quality assessments, and its staff is trained to specified standards of educational and continued professional development.

In addition, using the work of internal audit should not be a reactive or ad hoc process. There is scope for internal and external audit to communicate plans in such a way as to coordinate activity with a view to supporting and assisting each other as appropriate. When properly planned, this cooperation and the benefits it promotes do not affect the independence of either party.
Research by the Center for Audit Quality and The IIA in 2014 concluded that collaboration among the audit committee, internal audit and external audit help organizations succeed.

“Successful organizations will recognize the importance of building and sustaining effective relationships among the audit committee, those responsible for the internal audit function, and the external auditor. There are efficiencies and enhancements that can be realized in risk assessment, risk management, and in the performance of the external audit, while respecting each stakeholder’s roles and responsibilities in accordance with professional standards.”

The Role of the Audit Committee

As mentioned previously, ISA 315 and ISA 610 identify an evaluation of internal audit’s independence, competence, approach, and quality control as the basis for determining whether its work can be trusted. However, this direction fails to account for the significant role the audit committee plays in determining the efficacy of both internal audit and external audit.

Audit committee oversight of both internal audit and external audit affects how assurance is provided to the organization. Audit committee support is vital to internal audit independence, scope, and resources. Therefore, any evaluation of the internal audit function must include an examination of whether the audit committee is fulfilling its oversight responsibilities. It is this oversight that ensures the independence of both internal audit and external audit, by:

- Ensuring adequate resourcing.
- Coordinating and aligning the internal audit plan and external audit engagements.
- Appointing and evaluating the need for periodic rotation of the external auditors.
- Hiring, firing and compensation matters relating to the chief audit executive (CAE).
- Performing due diligence to ensure the competence of internal auditors and external auditors.
- Considering reports received from internal auditors and external auditors.

Self-interest Concerns

Finally, the IAASB should consider two potential hazards associated with the current approach to determining the reliability of internal audit's work: variability across the profession in how evaluations are made (due to the current absence of objective, defined criteria), and subjectivity in an individual external auditor’s evaluation. These could contribute to the threat, or appearance, of self-interest bias because a determination that the work of internal audit is unreliable increases the amount of work and related fees required by external audit.

This risk of self-interest bias is compounded by direction in ISA 315 and ISA 610 that precludes the use of some of internal audit’s work out of hand.

“. . . the external auditor’s ability to use the work of the internal audit function in relation to significant risks will be restricted to procedures that involve limited judgement. In addition, where the risks of material misstatement is other than low, the use of the work of the internal audit function alone is unlikely to reduce audit risk to an acceptably low level and eliminate the need for the external auditor to perform some tests directly.”

This default position regarding significant areas of risk itself creates unintended risk by dismissing internal audit’s work outright and renders any evaluation of the function’s objectivity, competency, approach, and quality moot.
If anything, this is the area where internal audit's work should be most valued. As mentioned earlier, internal audit's place as an independent assurance provider on internal controls across the organization makes it the default expert. Indeed, risk-based internal auditing by definition is built on providing assurance on risk management and internal control. Internal audit planning, resource allocation and focus — in close consultation with senior management and the board — are driven by the significance and likelihood of these risks.

Once reliability has been determined — based on conformance to IIA Standards and an examination of the oversight role of the audit committee — that reliability is absolute across the work of internal audit. It does not lessen because more judgement has been required or the risks are higher. Once again, this direction in ISA 315 and ISA 610 raises the risk, or perception, of self-interest bias.

The IAASB should consider providing the external auditor an “apply-or-explain” option with regard to reliance on the work of internal audit. An external auditor that concludes the work of internal audit is not reliable should provide details for how that conclusion was reached. For example, the work of internal audit may not cover or fully cover the scope of what the external auditor is seeking to address. Without such an “apply-or-explain” option, the risk or perception of self-interest bias remains.

It may be beneficial to examine the parallel direction in IIA Standards on reliance on outside assurance providers. IIA Standard 2050: Coordination and Reliance addresses how a CAE should approach and assess the work of other assurance providers.

The chief audit executive should share information, coordinate activities, and consider relying upon the work of other internal and external assurance providers to ensure proper coverage and minimize duplication of efforts.

Not unlike ISA 610, the related interpretation of the standard identifies the need for the CAE to consider “the competency, objectivity, and due professional care” of the external assurance providers. It also goes on to direct CAEs to have “a clear understanding of the scope, objectives, and results of the work performed.” However, it does not limit reliance on the work of the external assurance provider, once its reliability is established.

Conclusion

The IIA wishes to thank IAASB for the opportunity to comment on ISA 315 revisions involving identification and assessment of risks of material misstatement. This response raises pertinent questions about the IAASB’s direction to PAIBs regarding reliance on the work of internal audit. The IIA encourages IAASB to consider a thorough review of ISA 610 to examine whether that direction leads to inconsistency, subjectivity, the potential for repeating internal audit’s work unnecessarily, and whether this creates a perception of self-interest.

57. Institute of Public Accountants

Risk response – It is unfortunate that the IAASB did not address ISA 330 when revising ISA 315 as the two standards are highly interrelated. The IPA is particularly concerned that auditors often display limited responses to increased risk i.e. a decrease in materiality and/or an increase sample size. The materiality response is particularly a concern as in isolation (unless coupled with a sampling methodology) has no direct effect on the nature and extent of audit procedures.

63. SMPC

The revision introduces new, closely interrelated and as yet untested terms, concepts and definitions including inherent risk factors, relevant assertions, a spectrum of risk, and a great deal of granular material on IT issues. Terminology has been inappropriately imported from the PCAOB’s standards and many
other aspects are over-engineered for the SME environment. Cumulatively, this may trigger, if not mitigated, a rejection of the standard in terms of its suitability for SME audits and further calls for different standards for SME audits compared to listed/ PIE audits. We understand that SMPs are not alone in concerns regarding unnecessary complexity and that larger firms also have similar concerns.

64. Wirtschaftsprüfer

The IAASB is proposing to introduce terminology specifically from the US PCAOB’s standards (“reasonable possibility” and “more than remote likelihood” – see ED ISA 315.16(h)) without exploring whether these terms are aligned to the overall objective of an ISA audit (to reduce audit risk to an acceptably low level) and related concept of reasonable assurance. This non-ISA terminology potentially introduces a lower risk assessment threshold, and a corresponding increased risk response work effort.