

ISA 315 (Revised)¹—Issues and Recommendations

Objective of the Agenda Item:

To obtain IAASB views about proposed changes to Exposure Draft ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement* (ED-315) to respond to comments received. In particular, the ISA 315 (Task Force) is looking for Board member's views about:

- (a) The approach to addressing broader complexity and scalability/proportionality issues raised (see Sections II and V of this Agenda Item); and
- (b) Specific proposed changes to address comments and issues from the responses to ED-315.

I. Introduction and Approach to this Paper

1. Seventy-two responses were received to ED-315 from a broad range of stakeholders (see **Appendix 1**). An overarching theme throughout the responses related to the complexity of the proposals, as well as the scalability and proportionality of the proposed standard. There were also many comments related to individual aspects of the proposals, some supporting the specific changes that had been proposed, while other comments highlighted concerns or disagreement.
2. The ISA 315 Task Force (the Task Force) has met twice to analyze the responses and has spent significant time deliberating appropriate responses to address the broad concerns and issues raised relating to complexity, and scalability/proportionality, as well as had comprehensive discussions about the technical aspects of some individual aspects of the standard. The members of the Task Force and its activities since December 2018 have been noted in **Appendix 3**.
3. In analyzing the responses and considering appropriate responses to the issues raised by the respondents to ED-315, the Task Force:
 - (a) With regard to the requirements:
 - (i) First focused on issues raised in relation to individual key requirements, deliberating possible changes to clarify and enhance the individual requirements where needed.
 - (ii) Considered how the purpose of the required procedures had been presented (i.e., “why” the auditor is required to do something), in particular in relation to the understanding of the system of internal control.
 - (iii) Further reflected on the individual changes being considered to each requirement, as well as the broad overarching responses highlighting concerns about complexity and scalability/proportionality. In doing so, the Task Force also considered the extant requirements in light of the proposals in ED-315 and any further changes being considered. From this exercise, the Task Force agreed that to be responsive to the overall comments about complexity and scalability/proportionality, a more overall response was needed. Accordingly the Task Force worked through a section of the requirements to think through an alternative way of presenting the requirements (i.e., a fourth column presenting this

¹ Proposed International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

alternative has been included in the table of drafting in **Agenda Item 4-A**. The Board's discussions in this area are not only relevant to the project to revise ISA 315 (Revised), but will also impact the work of the Less Complex Entity (LCE) Working Group and the Board's future work more broadly.

- (b) With regard to the application material, considered ways to 'streamline' the application material to address issues raised regarding length and complexity, and to focus on the scalability/proportionality of the guidance. The Task Force agreed that changes to address individual issues within the application material would be deliberated once further progress had been made in addressing the issues related to the requirements first.
- 4. Not all of the individual aspects of the proposals and the related feedback have been addressed in this paper—any matters not addressed herein, including all matters related to Information Technology (IT), will be discussed in June 2019.
- 5. In context of paragraphs 3 to 4 above, the following sets out a summary of the matters presented for discussion at the March 2019 IAASB meeting:
 - (a) The Task Force's views in relation to proposed changes to the **requirements** to address issues from the responses to ED-315, including:
 - (i) An overall proposed response for Board discussion with regard to addressing the broad overarching comments received about complexity and scalability/proportionality (see **Section II**, paragraphs 19-33 of this paper and **Agenda Item 4-A** (Column 4));
 - (ii) Proposed changes to address individual matters raised relating to understanding the system of internal control (see **Section III**, paragraphs 47-59 and 67–83 of this paper, and Column 3 and the Appendix to **Agenda Item 4-A**); and
 - (iii) Individual matters relating to the auditor's identification and assessment of the risks of material misstatement and other issues (see **Section IV**, paragraphs 84–137 of this paper).
 - (b) **Section V** presents the Task Force's view, including an example of revised drafting of a possible response to address the comments on complexity and scalability/proportionality in the **application material**. The Task Force will present the revised application material on the basis of these discussions for the Board's consideration at the June 2019 IAASB meeting.

Presentation of Respondents' Comments

- 6. The Task Force has used Nvivo² to assist with the analysis of comments. This is a new technology that is being used, and the approach is therefore different to how respondents' comments have been presented in the past. The following sets out how the comments have been assimilated to present the matters set

² NVivo is a qualitative data analysis software package. It has been designed for qualitative researchers working with rich text-based and/or multimedia information, where deep levels of analysis on small or large volumes of data are required. NVivo helps Staff organize and analyze the text of comment letters. The software allows Staff to classify, sort and arrange information; examine relationships in the data; and combine analysis with linking, shaping, and searching. Staff, with the input of Task Forces, can test theories, identify trends and cross-examine information in a multitude of ways using its search engine and query functions. They can make observations in the software and build a body of evidence to support the Task Force or Board proposals.

out in each of the “Respondents’ Comments Sections” of this Agenda Item. A demonstration relating to Nvivo will be included in the Board’s March meeting agenda.

7. The high-level summary of respondents’ comments within this Agenda Item are intended to support the changes being proposed by the Task Force to respond to the overarching and individual issues raised. These summaries therefore do not include all of the matters raised by respondents, including where respondents supported the proposals or where there were individual comments that have not been specifically addressed. In arriving at its conclusions, however, all comments made by respondents have been considered by the Task Force.
8. To navigate between the actual responses and the matters related to respondents’ comments presented in this Agenda Item, Excel summary spreadsheets have been prepared by IAASB Staff for each relevant section to analyze which respondents have commented (each Excel summary spreadsheet is in a tabular format setting out a listing of respondents and broad themes within the responses, and indicating if a respondent had made a comment within that broad theme). Each Excel summary spreadsheet also indicates the support for the relevant proposals, as well as where individual or editorial comments were received (that may not have been noted specifically in this Agenda Item). Each Excel summary spreadsheet links back to a report generated using Nvivo (noted at the top of the each Excel summary spreadsheet).
9. Each Nvivo report contains the respondents’ answers to a specific question from ED-315. The only exception is that anything related to IT has been removed and will be assembled in one report for the purpose of the discussions about changes relating to IT planned for the June 2019 IAASB meeting. Accordingly, matters noted within this Agenda Item relating to respondents’ comments can be traced back to the Excel summary spreadsheet, and from there to the individual comments made in the Nvivo report.
10. A listing of the relevant Nvivo reports and the corresponding Excel spreadsheets can be found in **Appendix 2**.

II. Overarching Issues Relating to Complexity and Scalability / Proportionality in the Responses to ED-315

Summary of Respondents’ Comments Relating to Complexity and Scalability / Proportionality (see Nvivo Reports 1A and 2A, and Excel Summaries 1B and 2B)

11. Notwithstanding the support expressed within the respondents’ comments on many of the individual aspects of the standard, including support for many of the clarifications made, the following overarching themes have been noted:
 - The proposed changes have introduced a level of complexity that makes the flow of the standard difficult to understand and will therefore be difficult to apply;
 - The increased length, language used and structure have made the standard more difficult to understand; and
 - Ongoing significant concern about the scalability and proportionality of the proposed revised requirements.

Complexity and Understandability

Monitoring Group Responses

12. Two MG members have highlighted the importance of carrying the changes introduced in ED-315 to ISA 330³ so that the two standards are consistent (i.e., to align the revised risk assessments with the design and performance of the appropriate responses).

Other Responses

13. Overall, in addition to the various clarifications or changes called for, the following specific concerns have been raised that apply to the standard more broadly:
- The standard is overly complex and too detailed (or prescriptive), with various respondents noting it is not understandable and is over-engineered for audits of small- and medium-sized entities (SMEs).
 - The overall length of the standard.
 - Inconsistencies in terminology, which may result in less consistency.
 - The iterative nature of the standard is not clear.
 - The flow of the standard is difficult to follow, and there were various aspects noted as being circular.
 - The increased number of concepts and definitions sometimes make it difficult to understand what is required. In addition, it was noted that some of the concepts introduced, lack clarity. In particular, the spectrum of risk, significant classes of transactions, account balances and disclosures (SCOTABDs) and relevant assertions, and inherent risk factors have been variously noted.
 - The overall risk identification and assessment process is too complex, and could be simplified.
 - The introductory paragraphs and flowcharts, although very helpful, should not be what is used to navigate the standard.
 - Introduction of concepts from the US Public Company Accounting Oversight Board's (PCAOB) Standards, which may be confusing and introduce different thresholds.
 - The proposed requirements will lead to excessive documentation in many cases.
 - The proposals have been written like a firm's methodology.
 - There is now a disconnect with ISA 330 as the new concepts introduced in ED-315 have not been flowed through that standard.
14. There was also a view that the standard has been developed too quickly, with fundamental changes being proposed that will likely add to the time needed for the audit but with no, or little, added benefit.

³ ISA 330, *The Auditor's Responses to Assessed Risks*

Scalability and Proportionality

Monitoring Group Responses

15. One MG member has the view that it is essential that scalability be addressed so that this does not inhibit implementation.
16. Another MG member, recognizing that the standard needs to be applied by entities of all sizes and there is a current focus on scalability, has called on the IAASB to make sure that the standard can also be used by very complex entities. This 'scaling up' includes elevating certain aspects of the application material to requirements.

Other Responses

17. Respondents supported some of the aspects of scalability in the proposals, such as the recognition of less formal policies and procedures. However, significant concerns relating to scalability and proportionality still remain. In addition to specific instances where additional application material or guidance has been called for regarding the scalability / proportionality of the relevant requirement, broader comments relating to scalability / proportionality that may make the standard difficult to use include:
 - The standard does not sufficiently address scalability / proportionality, in particular within the requirements.
 - An approach that is too scaled down for risk assessment could have a significant impact that results in a different audit quality between smaller entities and large complex listed entities.
 - It was noted that consideration should be given to how the scalability guidance is presented and to who it applies, and that listed entities should be excluded.
 - More examples have been asked for to show how to scale down, and up.
 - Further consideration should be given to how the requirements really apply to different size entities, and whether they are suitable for all entities.
 - Respondents did not support embedding the scalability throughout the application material, and called for separate paragraphs to highlight these considerations.
18. Suggestions to address some of these issues included rewriting the standard using a 'building-blocks' approach to "think simple first", and a separate guidance document to be published at the same time as the standard that sets out how to apply the standard to audits of less complex entities.

Task Force Views

19. As noted in the introductory section, the Task Force has focused particular attention on what can be done to address the overarching comments relating to complexity and scalability/proportionality in the changes to ED-315 that are proposed for Board consideration.
20. **Agenda Item 4-A** presents the proposed drafting related to the discussion below and should be read with the explanations that follow:
 - Column 3 of **Agenda Item 4-A** sets out the proposed changes related to the individual aspects of ED-315 for 'Understanding the Entity's System of Internal Control' (see paragraphs 47–59 and 67–83 of this paper for explanations of these changes). The Appendix to **Agenda Item 4-A** provides a marked version of the changes proposed in Column 3 to ED-315.

- Column 4 of **Agenda Item 4-A** sets out an example of how the requirements related to 'Understanding the Entity's System of Internal Control' could be drafted using a different approach (explained in paragraphs 22–33 below), while also taking into account proposed changes for respondents' comments on the individual requirements (presented in Column 3 of the table).
 - The table in **Agenda Item 4-A** also provides the context of the ED-315 requirements in Column 2 and the extant requirements in Column 1. The Task Force encourages the Board to consider the differences in the requirements in Columns 3 and 4, as well as each of these columns in relation to the requirements from both extant ISA 315 (Revised) and ED-315.
21. Notwithstanding that the presentation of the requirements in Column 3 and Column 4 look different, the intention of the Task Force is that the outcome (i.e., the auditor's actions) are expected to be the same.
22. In considering changes to address the concerns raised about the requirements more broadly, the Task Force determined that a more overarching or overall response needed to be developed for discussion with the Board. In considering this overall response, the Task Force has been mindful of the diverse calls from respondents to:
- Maintain 'principles-based' standards;
 - Use simpler language, and reduce overall complexity within the requirements;
 - Maintain the robustness of the requirements; and
 - Enhance the consistency of application.
23. The Task Force decided to explore the application of an overall response to one section of the standard, and obtain Board views on this before applying this to the whole standard. Accordingly, the principles established in discussions with the Board at this meeting on alternative approaches to drafting the requirements related to "Understanding the Entity's System of Internal Control" will then be applied by the Task Force to the other requirements within the standard for presentation and discussion with the IAASB at its June 2019 meeting.
24. In exploring ways to develop an overall response, the Task Force considered how to address, in a different manner, the more detailed aspects within the requirements in both extant ISA 315 (Revised) and ED-315. The Task Force sought to take an approach that would 'simplify' the requirements but not diminish their robustness, while also promoting and maintaining consistency in their application. The Task Force considered that this could be achieved by:
- Using simpler, more straightforward language for each requirement.
 - Combining or separating requirements, as appropriate, to enhance their understandability.
 - Presenting the requirements at a higher level, and keeping them focused on the high-level "**what**" has to be done and the high-level "**why**" it has to be done. The Task Force is of the view that keeping each of these elements is essential to support clarity and consistent application.
 - Addressing unambiguously, and with appropriate authority, the "**how**" elsewhere in the standard (for example, using definitions more, and considering what further can be included in application material and appendices).
 - Drafting requirements with a consistent structure so that it does not appear that one requires a different approach from another when that is not the intention; and
 - Reducing cross-referencing within the requirements to reduce complexity.

- Further clarify the nature and extent of work effort in relation to various aspects within each component.
 - Address perceived inconsistencies in terms, and use terms that are clear, that will not result in inconsistency in their application.
25. In light of the Board's direction about how to proceed, further consideration will need to be given to both application material and other guidance needed to support the revised requirements. In addition, once the approach to the definitions has been considered, further consideration will be given by the Task Force to individual respondent comments relating to the definitions themselves (where not addressed in this paper).
26. In developing the proposed requirements in Column 4, the Task Force has proposed definitions⁴ for each of the components of the system of internal control. This approach relocates the details about each component from the requirements to the definitions. For purposes of comparison, Option 1 in Column 3 (and Columns 1 and 2) maintains the details of the components in the requirements, while Option 2 in Column 4 illustrates the requirements redrafted without the details as well as presents draft definitions for each component.
27. The Task Force is of the view that the Option 2 approach to use definitions for each component (versus an approach to only describe the components in the application material or an appendix to the standard) is most appropriate to retain the appropriate authority of the aspects of the component that are required to be understood. That is, the defined terms are embedded in the requirements and are supported by the authoritative definitions of the terms in the definitions section of the standard. As part of this approach, the application material would also be enhanced to reinforce that the definitions provide the aspects of the component that are to be understood. The Task Force is also of the view that using clear definitions for each component would promote appropriate consistency in the understanding required.
28. If this approach of establishing definitions for the components of the system of internal control is supported by the Board, the Task Force will give further consideration to further improvement of these definitions. For example, an alternative to the presentation of the definitions in Column 4 may be to significantly shorten the definitions but refer within the definition to a broader description of each of the particular aspects in an Appendix. This would result in simpler definitions but this simplicity would need to be weighed against the fact that an auditor would need to read the requirements, the definitions and the Appendix together to fully understand the relevant requirements.
29. The Task Force recognizes that relocating such detail to definitions will not result in reducing the length of the standard. However, on balance, the Task Force is of the view that the use of definitions may be an appropriate mechanism to reduce the complexity of the requirements, while retaining the robustness of the extant standard, as well as fostering the appropriate level of consistency in the auditor's application of the requirements. The Task Force specifically seeks the Board's views on the use of definitions in implementing an overall response.

⁴ Paragraph A60 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* sets out that the contents of the ISAs contains application and other explanatory material, and definitions, and that the entire text of the ISA is relevant to understanding of the objectives stated in an ISA and the proper application of the requirements of an ISA.

30. The following table provides a comparison between the requirements as drafted in Columns 3 and 4 of the table in **Agenda Item 4-A** (it is intended that the table below should be read together with the table of drafting in Agenda Item 4-A):

	<p><i>Explanation of the differences and similarities between Column 3 and Column 4 in the Table in Agenda Item 4-A</i></p> <p><i>(Refer to discussion in paragraphs 47-59 and 67-83 for specific changes to ED-315)</i></p>
Risk assessment procedures and related activities (paragraph 17 of ED-315)	<ul style="list-style-type: none"> • The requirements are the same in both columns. • This paragraph has been included in the table to provide context for the purposes of risk assessment procedures (i.e., 17(a) and (b)).
Understanding of the entity's system of internal control (paragraphs 25–26 of ED-315)	<ul style="list-style-type: none"> • The columns are the same with the exception that Column 4 does not include that an additional purpose of obtaining the understanding is to provide the auditor with a basis for the communication of control deficiencies to management (this is explicitly stated in Column 3). <ul style="list-style-type: none"> ○ In Column 4 this is an exception to the basic principle of including the high-level “why” in the requirement; however, the Task Force intends that this “why” will be presented in application material to the requirement in Column 4. • Paragraph 26 has been deleted in both Columns 3 and 4 to reduce cross-referencing in the requirements.
<p>The control environment (paragraphs 27–28 of ED-315)</p> <p>The entity's risk assessment process (paragraphs 29–31 of ED-315)</p> <p>The entity's process to monitor the system of internal control (paragraphs 32–24 of ED-315)</p>	<p><i>Applicable to all three components:</i></p> <ul style="list-style-type: none"> • The ‘understanding’ and ‘evaluation’ requirements have been combined in Column 4. • The evaluation aspect of the requirements are the same in both columns. • The detail about what specific aspects of the specific component needs to be understood has been removed from the requirements in Column 4 and is now included in the definitions (see <i>Example new definition</i> in respect of each component in Column 4). <p><i>Relevant to the control environment:</i></p> <ul style="list-style-type: none"> • The specific aspects of the component to be understood are consistent between paragraph 28 in Column 3 and the new proposed definition in Column 4. <p><i>Relevant to the entity's risk assessment process:</i></p> <ul style="list-style-type: none"> • The specific aspects of the component to be understood are consistent between paragraph 29A of Column 3 and the new proposed definition in Column 4.

	<p><i>Explanation of the differences and similarities between Column 3 and Column 4 in the Table in Agenda Item 4-A</i></p> <p><i>(Refer to discussion in paragraphs 47-59 and 67-83 for specific changes to ED-315)</i></p>
	<ul style="list-style-type: none"> Both versions retain paragraph 30, which is a conditional requirement (also in extant) for the auditor to take action when applicable. <p><i>Relevant to the entity's process to monitor the system of internal control:</i></p> <ul style="list-style-type: none"> The required understanding of the entity's internal audit function has been built into the overall requirement to understand and evaluate in paragraph 32 (Column 4). The specific aspects of the component to be understood are consistent between paragraphs 32A (a) and (b) of Column 3 and the new proposed definition in Column 4. Both versions retain paragraph 33, which is a specific requirement (also in extant) to understand the sources of information.
The information system and communication (paragraphs 35-37 of ED-315)	<ul style="list-style-type: none"> The 'understanding' and 'evaluation' requirements have not been combined into a single paragraph. Although this results in a difference in the structure of the requirements for this component, the Task Force believes that the separation is warranted given the complexity of what has to be addressed in this component, so as to keep each part sufficiently clear and understandable. The detail about the matters to be understood in relation to the information system has been removed from the requirements in Column 4 and is now included in the definitions (see <i>Example new definition</i> in Column 4), although the 'scoping' of the auditor's understanding to SCOTABDS is within the requirement to 'understand' in both versions. The new proposed definition of the information system in Column 4 also includes reference to communication as the definition addresses the whole component. Paragraph 37 relating to communication remains the same for both columns.
Control activities (paragraphs 38-39 of ED-315)	<ul style="list-style-type: none"> Paragraph 38 has been deleted in both Columns 3 and 4 to reduce cross-referencing in the requirements. The controls to be identified (i.e., the "what") in respect of this component are the same in both columns. With regard to controls that are required to be identified using the auditor's judgment, Column 3 provides a fuller discussion

	<p><i>Explanation of the differences and similarities between Column 3 and Column 4 in the Table in Agenda Item 4-A</i></p> <p><i>(Refer to discussion in paragraphs 47-59 and 67-83 for specific changes to ED-315)</i></p>
	<p>of the use of professional judgment in the hanging paragraph to paragraph 39, while Column 4 retains the reference to the auditor's professional judgment in paragraph 39(c).</p> <ul style="list-style-type: none"> ○ The Task Force intends that the fuller discussion about professional judgement in the hanging paragraph in Column 3 would be included in application material to the requirement in Column 4 as this addresses "how" the specified controls (i.e., the "what") are to be identified).
<p>Paragraphs 42–44 of ED-315 (note paragraphs 40-41 relate to IT, which will be discussed further with the Board in June 2019).</p>	<ul style="list-style-type: none"> • The requirements are the same in both columns.

31. Therefore, in summary:

- Both Column 3 and Column 4 are principles-based requirements focused on the "what" and "why," with the exception noted to paragraph 25.
- The robustness of the requirements in ED-315, together with any proposed enhancements to address individual aspects, has been maintained in both columns.
- Both columns set out the detailed aspects of the understanding to be obtained, however Column 3 includes this information in the requirement itself (which makes the requirements longer), whereas Column 4 sets out the information in a new proposed definition (and therefore the requirements will be shorter).
- The evaluations required for each requirement are the same in both columns.
- The individual revisions made in Column 3 may be seen to be responsive to individual comments, in particular where clarity has been sought, but may not be seen to be responsive to concerns raised about length and understandability.
- The revised requirements in Column 4, although shorter, may lose some of the clarity of the proposed changes, and may be considered more complex (as the auditor has to go to both the requirement and the definition for their understanding of what is required). In addition, more application material may be needed to support these higher-level requirements.

32. The Task Force is mindful that this is one way to approach a different presentation of the requirements, and will look for Board views about this approach generally, as well as relating to the suggested changes. The Task Force recognizes that there may be other ways to approach revising the standard to address the issues identified relating to complexity and scalability/proportionality more broadly, and there are certainly many variations to the requirements that fall between the way the requirements are presented in Column 3 and Column 4.

33. The Task Force has the view that clear direction from the Board is necessary as to the approach the Task Force should take to the requirements in order for the Task Force to progress the revised standard, notwithstanding that the Board will have specific comments related to the drafting.

Matters for IAASB Consideration

1. Board members are asked for views about the broad approach to apply an overall response to draft the requirements in a different way as set out in Column 4 of **Agenda Item 4-A** (and as explained in paragraphs 19–33 above). In particular, members are asked to comment on whether such an approach could be an effective way to address the overarching comments from respondents relating to complexity and scalability/proportionality, and if not, why not?
2. The IAASB is asked for its views about the manner in which the overall response developed by the Task Force has been applied in Column 4 (Option 2) of Agenda Item 4-A. In particular, the IAASB is asked:
 - (a) Whether the proposed requirements are presented at the correct level of detail, i.e., is there too little detail or too much detail?
 - (b) Whether there are important missing concepts from the requirements due to their presentation in this manner (both overall as well as for individual aspects)?
 - (c) Whether the use of definitions is appropriate and should be further explored, and if not, where should the detailed aspects related to understanding the individual components of internal control be presented?
 - (d) Whether there are any other matters the Task Force should consider in relation to the requirements presented in Column 4 of Agenda Item 4-A?
3. The IAASB is asked for whether the Task Force should pursue the presentation approach in Column 3 or Column 4 as it makes proposals to revise ED-315, or whether there is an alternative that should be further explored.

III. Specific Issues Related to Understanding of the Entity's System of Internal Control

Summary of Responses—Understanding the Entity's System of Internal Control Overall

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

Monitoring Group Responses

34. One MG member emphasized the importance of understanding applicable laws and regulations, and had the view that this should be more explicitly reflected in the definition of the system of internal control, in particular in relation to prudential regulations.
35. One MG member suggested that it should be made clear that, in relation to understanding controls where substantive procedures alone do not provide sufficient audit evidence, this would apply where there are complex estimates when the risk of material misstatement is high.
36. One MG member noted confusion in relation to the wording of the requirements 'to obtain an understanding' through or by 'understanding.'

37. One MG member noted inconsistencies in what was required in relation to the system of internal control, in particular in relation to what is to be ‘understood’ and where an evaluation is required, which may result in inconsistency and diversion in practice.

Other Respondents’ Comments

38. Support was expressed by respondents for:
- The distinction between ‘direct’ and ‘indirect’ components of internal control. There were respondents, however, that asked that this be better presented (for example through the use of headings) or that these terms be defined.
 - The delineation between ‘understanding the components of internal control’ (paragraph 25) and ‘identifying controls relevant to the audit and evaluating the design of such controls’ (paragraph 26). However, the introduction of paragraph 26 seemed to suggest to some respondents that the evaluation of design and determination of implementation (D&I) was required for all components of internal control.
39. There were mixed views expressed about the changes providing specificity within the requirements to help the auditor understand “what” is needed to be understood for each component of internal control. There were respondents who welcomed the enhancements, while others (in particular those representing small and medium practices (SMP)/SME interest groups) saw these changes as adding additional prescription and complexity, and urged the IAASB to revert to more principles-based standards. It was also noted that the flowcharts were easier to understand rather than the presentation of the requirements in the standard.
40. Although there were comments noting the greater clarity in relation to what is required when obtaining an understanding of each component of the system of internal control, it was highlighted that the purpose of obtaining this understanding was still not clear, especially in circumstances where the auditor intended to take a substantive approach to the audit.
41. There were also respondents (again largely representing SMP/SME interests) that are still of the view that obtaining an understanding of the system of internal control is unnecessary if the auditor plans to undertake a fully substantive approach.
42. Respondents, including a respondent from the Monitoring Group as highlighted above, noted confusion in relation to the requirements ‘to obtain an understanding’ through or by ‘understanding,’ and suggested that it should be made clearer that risk assessment procedures are required to obtain the relevant understanding.
43. Another term noted as problematic is ‘relevant to financial reporting,’ in particular as it relates to the scope of the auditor’s understanding of the information system component, which adds to the lack of clarity of what is required.
44. Respondents also expressed concerns about the required work effort in obtaining the understanding of each component of the system of internal control, and whether, for example, inquiry alone may be sufficient in certain circumstances.
45. Respondents noted concern about the nature and extent of work required for the various ‘evaluations. Although it was acknowledged that the requirements for understanding are separated from those that address the evaluation of the components of the system of internal control, it was not clear the extent of evidence needed (e.g., whether it needed to be corroborative) to support the ‘evaluation’ in relation to the ‘indirect’ components of the system of internal control, and whether the ‘evaluation’ provides any “comfort,”

in particular in relation to the control environment. It was also noted that there is confusion between the evaluation required for the purposes of the indirect components versus the evaluation of the D&I of specific controls identified to be relevant to the audit. There were respondents who suggested that the 'evaluation' requirements within each of the components of the system of internal control be revised so that they are similar.

46. Various inconsistencies were noted:

- Use of 'including the extent to which it has been formalized' in paragraphs 29 and 32 of ED-315 in regard to the entity's risk assessment process versus the evaluation of the 'formality' of various aspects in paragraph 29(a) of ED-315 in regard to the entity's process to monitor the system of internal control – the latter may appear to be a binary decision. Respondents did note, however, that the introduction of this aspect was a helpful clarification recognizing situations where processes were being undertaken but may not be documented.
- In the use of 'system of internal control,' controls,' 'internal control' – it was noted that it is not clear whether these are the same concepts used in different contexts, or different concepts.

Task Force Views— Proposed Changes to Understanding the Entity's System of Internal Control Overall

47. Column 3 of Agenda Item 4-A sets out the changes proposed by the Task Force to address the specific aspects described further below. The discussion that follows in this section explains these changes. Column 4 has been built from Column 3 and is described further in Section II above.
48. Although certain respondents, largely representing the SMP/SME community, challenged whether an understanding of the system of internal control is necessary when the auditor takes a fully substantive approach, other respondents did not have this view and were more focused on the scalability/proportionality aspects of audits of SMEs, which is consistent with the view of the Board. The Task Force acknowledges that further changes are needed to make clear throughout this section of the standard why the understanding is obtained (i.e., the purpose) as this may help with understanding why it is required, both overall and for each component.

Overarching Requirement to Obtain an Understanding of the Entity' System of Internal Control (Paragraphs 25 and 26 of ED-315)

49. Paragraphs 25 and 26 in ED-315 are intended to set out the overall requirements for obtaining an understanding of the system of internal control, explaining that this is done through understanding the five components of internal control, and to help the auditor understand which controls are relevant for the purpose of the audit (i.e., for which the auditor needs to evaluate the design of, and determine whether the control has been implemented (D&I)). Some of the broader feedback noted above applies to these requirements, in particular the purpose for obtaining an understanding of the entity's system of internal control (i.e., why this understanding is required).
50. In considering how to build the purpose for obtaining the necessary understanding into the standard, the Task Force agreed that the reasons for performing risk assessment procedures are relevant to the understanding of the system of internal control, as well as the understanding of the entity and its environment and the applicable financial reporting framework. Accordingly, the Task Force agreed that the broader 'purposes' for obtaining these collective understandings should be reflected in paragraph 17 of ED-315. That is, the collective understandings, including the system of internal control, are obtained to provide an appropriate basis for:

- The identification and assessment of the risks of material misstatement; and
 - Designing further audit procedures in accordance with ISA 330.
51. This has now been explicitly stated in paragraph 17, and in the view of the Task Force this would in effect help those respondents that had noted uncertainty as to why the understanding of the system of internal control is needed if a fully substantive audit approach was to be used. The Task Force intends to enhance the application material to paragraph 25 to explicitly describe the linkage between the purposes of risk assessment procedures in paragraph 17 and the required understanding of the system of internal control. In particular, the Task Force is of the view that obtaining the understanding of the system of internal control *informs* the identification and assessment of the risks of material misstatement, and will enhance the application material to reflect this.
52. With specific regard to understanding the entity's system of internal control, the Task Force agreed that an additional purpose would also be the auditor's identification of control deficiencies based on the understanding obtained, which are then communicated to management and those charged with governance in accordance with ISA 265.⁵ Paragraph 25 of ED-315 (i.e., the broad paragraph addressing specifically obtaining an understanding of the system of internal control) has been amended to reflect this additional purpose.
53. The Task Force is also of the view that the overarching requirement should make clear that the nature and extent of work to understand the entity's system of internal control depends on the nature and circumstances of the entity, and has enhanced the requirement in paragraph 25 to explicitly state this as well. Further consideration will also be given to the related application material, which will be enhanced as necessary to provide examples to illustrate scalability to different circumstances (i.e., 'scaling up' and 'scaling down'), although also recognizing that some of these are already within the application material.
54. The Task Force proposes deleting paragraph 26 of ED-315, as its intention had been to establish upfront the overall requirement to identify and evaluate D&I of controls relevant to the audit, but the inclusion of this requirement has in effect increased the complexity of the requirements, and may have suggested to some respondents that there was an overall requirement for D&I in each of the components of internal control when there is not. This deletion is also responsive to comments that the multiple cross-references in ED-315 added to the complexity of the requirements.

Other Broad Proposed Changes to Understanding the Entity's System of Internal Control

55. Legacy issues have clouded the use of the terminology '*controls relevant to the audit*,' with confusion noted about what it is intended to apply to. In addition, the precise scope of '*controls relevant to the audit*' has always been an area of contention, and the changes in ED-315 attempted to clarify this by specifying which controls are 'relevant to the audit' (i.e., use the terminology only in the context of those controls where D&I is required). However, the responses to ED-315 still noted concerns about the use of this terminology. Accordingly, the Task Force proposes to remove the terminology '*controls relevant to the audit*,' and proposes to simplify the requirement to identify controls (i.e., that meet the specified criteria). By doing so, the Task Force is of the view that there is no need to therefore use the term "*relevant to the audit*." The Task Force also notes that these controls are all required to be understood in extant ISA 315 (Revised), and that ED-315 had only grouped them in the same place. As a result, there should be no additional work to what is required today, and therefore, notwithstanding proposed removal of the

⁵ ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

terminology *controls relevant to the audit*, the requirement to identify those specific controls would be retained.

56. In a similar vein, the term “*relevant to financial reporting*” also appears confusing to respondents, and the Task Force proposes to, in the context of the understanding of the system of internal control, replace the reference to ‘*relevant to financial reporting*’ with language that requires the auditor to understand how the entity’s system of internal control ‘*supports the preparation of the financial statements*’ with the additional context of ‘*given the nature and circumstances of the entity*’ or ‘*in accordance with the applicable financial reporting framework*’ where relevant.
57. Similar to the approach taken in the ‘*Obtaining an understanding of the entity’s system of internal control*’ requirement in paragraph 25 of ED-315, the Task Force has reconsidered the requirements in relation to each component of the system of internal control, and has proposed a consistent structure (Column 3 of Agenda Item 4-A) that emphasizes the purpose of each requirement upfront, followed by the nature or scope of the procedures, and the evaluation of the procedures. The Task Force has further debated whether a single requirement that requires the evaluation of all the components would be appropriate instead of individual requirements in each component. However, in the view of the Task Force, separate evaluations are more practical as each evaluation is dependent on the nature and circumstances of the entity and the structure of its system of internal control, in addition to the understanding obtained specific to each component.
58. To address concerns regarding inconsistencies of language for the same concept, with reference to paragraph 31(a) of ED-315, the term ‘*including its formality*’ has been replaced with ‘*including the extent to which it is formalized*.’ This change was made to align with the wording in the existing lead-in paragraph of this component and was noted as preferred by respondents.⁶ Although there was concern noted relating to the use of this term and what it may mean in practice, the Task Force is of the view that other respondents had welcomed its introduction (in particular enhancing the scalability of the standard) and so has agreed to keep it in the standard as appropriate.
59. The Task Force proposes to address the following in revisions made to the application material:
- Further clarification regarding the various ‘evaluations’ that are required, including distinguishing the evaluations in respect of the indirect components from D&I.
 - Further explanation regarding the types of procedures to be performed when understanding the components of internal control to clarify the confusion that has arisen in various paragraphs.

Matters for IAASB Consideration

4. The IAASB is asked for its views about the proposed individual changes, as presented in Column 3 of **Agenda Item 4-A** (and the Appendix to **Agenda item 4-A**), in particular:
- (a) Whether detailing the purpose of the required understanding, as explained in paragraphs 49–54 above, helps with concerns as to why an understanding is needed;
 - (b) Deleting paragraph 26 in ED-315 to reduce complexity and confusion; and
 - (c) Proposed changes to terminology as described in paragraphs 55–59 above.

⁶ ED-315, paragraph 29

Summary of Responses— Individual Issues Within the Each of the Components of the Entity's System of Internal Control (Para's 27–38 of ED-315)

(see Nvivo Reports 3-A and 4-A, and Excel Summaries 3-B and 4-B)

Monitoring Group Responses

60. One MG member suggested further consideration be given to the requirement to identify controls that, in the auditor's professional judgment are appropriate to perform D&I on, in particular noting that professional judgment is implicit in this requirement and also that use of professional judgment may be a broader requirement for the identification of all controls relevant to the audit.
61. Members of the MG noted concerns about aspects of paragraph 39 in relation to controls relevant to the audit, suggesting that certain clarifications were needed, in particular in relation to the evaluation of the design of the controls identified and the scope of paragraph 39(e).

Other Respondents' Comments

62. As also briefly referred to in the overarching comments, from a complexity and scalability perspective, respondents:
 - Have expressed concern in relation to the control environment component, in particular that the requirement seems to assume a level of formality or complexity that is often not present in a less complex entity.
 - Questioned whether the auditor is always required to identify 'controls relevant to the audit,' in particular in relation to less-complex entities where the auditor generally adopts a fully substantive approach.
63. Although it was noted that the identification or 'listing' of controls relevant to the audit into a single requirement is helpful, respondents noted various issues relating to this concept including that there is still confusion about the term 'controls relevant to the audit' (although this may also be a legacy issue) as well as some of the specific aspects of the requirement to identify controls as relevant to the audit, noting that this requirement would be inconsistently applied. There was also confusion noted when controls not in the controls activities component would be 'relevant to the audit,' including a call for more examples in the application material to clarify different situations of 'controls relevant to the audit' in the indirect components of internal control.
64. There were many comments from respondents about confusion relating to controls that define the flows in the information system component (i.e., information system controls relevant to financial reporting) and calls for clarity through making a stronger distinction between these controls and the controls identified in the controls activities component that are 'relevant to the audit'. In particular, it was noted that it was not clear:
 - Whether the 'information system controls'⁷ were a subset of the controls relevant to the audit and the difference in the work effort for the evaluation of the D&I of these controls versus the controls relevant to the audit.
 - The meaning of application material in support of the control activities component, stating that *'controls in the control activities component include those controls over the flows of information*

⁷ ED-315, paragraph 36

within the information system relating to significant classes of transactions, account balances and disclosures and the financial reporting process uses to prepare the financial statements'.⁸ The guidance was interpreted to suggest that control activities may be limited to the information system component. This interpretation is inconsistent with COSO, which explains that the control activities component comprises control activities related to all of the other components of internal control.

- Which controls needed to be 'understood' within the information system component – i.e., only for those flows related to significant classes of transactions, account balances and disclosures, or to cover financial reporting more broadly.
 - How the 'significant' classes of transactions, account balances and disclosures could form the scope of the understanding of the flows of transactions when the requirement to identify them comes later.
65. With regard to the controls that had been identified as 'relevant to the audit,' respondents commented as follows:
- The scope of the controls that are relevant to the audit that are in the auditor's professional judgment (i.e., paragraph 39(e) of ED-315) needs to be clarified or further explained, as it is not clear what these could be and would therefore result in inconsistent application. It was also questioned whether this aspect is necessary as it would unlikely not apply in a non-complex environment, especially when the auditor is not intending to rely on controls.
 - Controls relevant to the audit, other than those that are relevant in the 'auditor's judgment:'
 - Disagreement with including controls relating to significant risks as controls that are relevant to the audit. This is in the context of audits of smaller and less complex entities where some auditors had the view that they were being asked to test the design of controls when it is not necessary as they would not be relying on these controls.
 - Questioning whether the auditor is in a position to identify controls relevant to significant risks during the '*understanding of the system of internal control*' phase, bearing in mind the auditor has yet to identify or assess risks of material misstatement, and therefore, determine significant risks.
 - Questioning whether all controls over journal entries should be 'mandated' as 'controls relevant to the audit.'
 - Greater clarity is needed as to how D&I of those controls relevant to the audit assists the auditor in identifying and assessing the risks of material misstatement at the assertion level (for example through illustrative examples).
66. It was also noted that there is no evaluation required in respect of the entity's process to monitor controls, with no explanation of why not.

⁸ ED-315, paragraph A160

Task Force Views—Individual Issues Within the Each of the Components of the Entity's System of Internal Control (Para's 27–38 of ED-315)

The changes set out below are illustrated in Column 3 of **Agenda Item 4-A** (and the Appendix to **Agenda Item 4-A**)

Control Environment (Paragraphs 27 and 28 of ED–315)

67. In line with the approach of the Task Force to give more prominence to the purpose of the required understanding of each component (see paragraph 27 in Agenda Item 4-A), the order of paragraphs 27 and 28 of ED–315 have been reversed and updated to focus on the intended outcome of the procedures for the component, which is the evaluation.
68. Recognizing concerns expressed in relation to the complexity of language used to describe the specific aspects of the control environment, the Task Force has reconsidered existing paragraph 27 of ED–315. In particular, the Task Force has redrafted each aspect of the required understanding by simplifying the language. In addition, despite the proposed changes in wording, the individual aspects of the requirement still capture the related principles in the COSO⁹ framework.
69. The Task Force proposes to address the following in revisions made to the application material:
- Further guidance regarding the types of information that is to be understood, for example to encourage the auditor to consider sources outside of the entity's financial department (e.g., an employee within 'operations' department may be the sole preparer of data or analyses that are utilized for financial reporting purposes).
 - Further guidance to support the replacement of the term '*relevant to financial reporting*' with '*supports the preparation of the financial statements given the nature and circumstances of the entity.*'

The Entity's Risk Assessment Process (Paragraphs 29–31) and The Entity's Process to Monitor the System of Internal Control (Paragraphs 32–34)

70. Consistent with the approach of the Task Force to give more prominence to the purpose of the required understanding of each component (see paragraph 67 above), the requirements of these components have been restructured.
71. In relation to the required evaluations of each component:
- With regard to *the entity's risk assessment process*, the evaluation has been enhanced to better explain the outcome of the auditor's procedures; and
 - With regard to the *entity's process to monitor the system of internal control* component, an evaluation has been added clarifying the outcome of the evaluation. For example, the auditor may determine that the absence of monitoring procedures are not appropriate in the particular circumstances, which may represent one or more control deficiencies. Requiring the auditor to evaluate the outcome of the understanding obtained is also consistent with the approach followed within the other components of the system of internal control.

⁹ The Committee for Sponsoring Organizations of the Treadway Commissions (COSO) Internal Control – *Integrated Framework* (2013)

The Information System and Communication (Paragraphs 35–37 of ED-315)

72. Consistent with the approach of the Task Force to give more prominence to the purpose of the required understanding of each component (see paragraph 67 above), the requirements of this component have been restructured to present the outcome first (i.e., the required evaluation).
73. The Task Force has recognized that there was significant confusion relating to the evaluation required in this component for “information system controls relevant to financial reporting,” and the D&I required for the controls relevant to the audit. Accordingly, the evaluation has been redrafted to make clear that this evaluation is for the purpose of determining whether the information system supports the preparation of the entity’s financial statements, which would hopefully distinguish this evaluation from the D&I required related to the controls in the control activities component. It has also been clarified that the evaluation is based on the understanding obtained within this component.
74. Comments were raised by respondents regarding the ‘scoping’ of this requirement, i.e., limiting the understanding to those elements relating to SCOTABDs only, expressing concern that the requirement to identify these SCOTABDs only appeared subsequently in the risk identification and assessment section of ED-315. The Task Force considered whether further changes are needed, and agreed that this was still the right way to scope the outcome of the understanding (i.e., the outcome of the auditor’s risk assessment procedures for the information system should be that all SCOTABDs are addressed regardless of the timing of their identification).
75. The Task Force also intends to further clarify, in the application material, that the understanding of the information system may be initially based on the expected SCOTABDs identified as an outcome of the understanding of the entity and its environment, and in particular the understanding of the applicable financial reporting framework. In addition, the understanding would be updated as refinements to the identification of the SCOTABDs occurs based on further information gained from the auditor’s risk assessment procedures. The Task Force further considered that on recurring audits, the SCOTABDs identified in the prior period audit would likely form a starting basis for the current period audit.
76. The Task Force also considered whether an evaluation should be required for the communication aspect of the information system and communication component to be consistent with the other components of the system of internal control, but agreed that there had been no comments received regarding this and therefore that no further changes would be made.

Control Activities (Paragraph 38 of ED-315)

77. The Task Force considered the respondents’ comments about the description of the control activities component in the application material being inconsistent with that of COSO because it seemed to limit control activities to only those related to the information system component. The Task Force agrees that the description should be revised to reflect that control activities address all the components of the system of internal control.
78. Based on the planned change to the description of the control activities component and the proposal to remove the concept of ‘controls relevant to the audit’ (see paragraph 55 above), and to reduce complexity in the requirements to perform D&I on the controls in this component, the existing requirement to understand the control activities component (by identifying controls relevant to the audit and by evaluating their design and determining their implementation whether they have been implemented),¹⁰ has been

¹⁰ ED-315, paragraph 38

removed. Accordingly, paragraph 39 has now been positioned as the requirement for the control activities component. This requirement continues to reflect the list of controls that are required to be identified, with the requirement for D&I of the identified controls in paragraph 42. The requirement in paragraph 39 has also been revised to clarify that in addition to controls identified from the information systems component, there may also be controls from the other three indirect components (i.e., controls that support controls that address risks of material misstatement).

79. The Task Force continues to have the view that the approach to setting out which controls need to be identified and D&I performed is helpful, and there was support for this approach from respondents. However, the Task Force has recognized the concerns of respondents in relation to including some of the specific controls, in particular those controls ‘that are identified in accordance with the auditor’s judgment’ and in relation to significant risks. With regard to the latter, this is an existing requirement and the Task Force has agreed it is appropriate to retain as the Task Force is of the view that the understanding of controls over significant risks is important to inform the auditor’s design of responsive substantive procedures, when the auditor does not intend to test those controls. Further, if the entity does not have controls over significant risks, this may result in the identification of controls deficiencies that, in the public interest, are to be communicated to management and those charged with governance.
80. With regard to controls identified using ‘the auditor’s professional judgment’ (paragraph 39(e) of ED-315, paragraph 39(c) in Column 3), the Task Force has removed the specific reference to ‘professional judgment’ because, on reflection, professional judgment applies to all of the requirements within the standard and the hanging paragraph to that requirement (i.e., to paragraph 39) includes an overarching statement about the use of professional judgment in the identification of controls. In addition, as the purpose of obtaining the understanding of the system of internal control has now been linked to paragraph 17 (see paragraph 50 above) there is no need to repeat the purpose here, rather a change has been made to cross refer to this objective in paragraph 17.
81. The Task Force has also enhanced the hanging paragraph in paragraph 39 (Column 3 of **Agenda Item 4-A**) to make clear the scope of controls that need to be identified by referring to controls relating to SCOTABDs, which is consistent with the scoping of the understanding obtained in the information system.

Evaluate the Design of Controls and Determining whether such Controls have been Implemented (Paragraph 42 of ED-315)

82. The concept of ‘controls relevant to the audit’ has been removed, and has been replaced with specific references to the paragraphs for which D&I is required. No other changes are proposed to the actual requirement for D&I.

Control Deficiencies Within the System of internal Control (Paragraphs 43-44 of ED-315)

83. No significant issues were raised by respondents relating to the paragraphs on control deficiencies, and accordingly there are no changes to these paragraphs.

Matters for IAASB Consideration

5. The IAASB is asked for its views about the proposed changes in the individual components of internal control, as presented in Column 3 of **Agenda Item 4-A** (and the Appendix to **Agenda item 4-A**), in relation to:
- (a) The control environment as explained in paragraphs 67–69 above;

- (b) The entity's risk assessment process and process to monitor the system of internal control as explained in paragraphs 70–71 above;
 - (c) The information system and communication component as explained in paragraphs 72–76 above; and
 - (d) The control activities component as explained in paragraphs 77–81 above.
6. Are there any other matters relating to understanding the entity's system of internal control that the Task Force should consider as it progresses the changes to ED-315?

IV. Specific Issues Related to Identifying and Assessing the Risks of Material Misstatement and Other Issues

84. The following sets out some discrete issues that the Task Force would like the Board's views on as it progresses the changes to ED-315 to respond to the comments received. The changes set out below are based on revising ED-315 to address specific comments received, but there may be further changes needed once the Board's views of the matters set out in Section II have been agreed.

Separate Assessment of Inherent and Control Risk

Summary of Responses (See Nvivo Report 5A and Excel Summary 5B)

Monitoring Group Responses

85. Three Monitoring Group (MG) members explicitly supported the clarification that the auditor should perform a separate assessment of inherent risk and control risk.

Other Responses

86. There was strong support noted for the separate assessments of inherent and control risk. One respondent expressed concern that separate assessments may result in a substantial increase in work and documentation for a small and less complex entity, noting that they should be assessed collectively rather than separately, while another was not sure how this would improve the robustness and consistency of the risk assessment.
87. There was support for the clarification that risks of material misstatement are identified based on inherent risk. However, it was suggested that, because "risk of material misstatement" is defined to be inclusive of inherent risk and control risk, ED-315 be clarified to require the identification of "inherent risks" instead of "risks of material misstatement."
88. Notwithstanding the support, various concerns were expressed in relation to how the auditor considers the combination of inherent and control risk in order to assess the risks of material misstatement as the standard does not explicitly require this (although noted within the introductory paragraphs there were respondents who asked for additional guidance about how this should be done).

Task Force Views

89. The Task Force is of the view that, due to the strong support, the inherent and control risk assessments should remain separate.
90. The Task Force recognized the issues related to the use of "risk of material misstatement" and specifically considered the suggested change to identify "inherent risks" instead of "risks of material misstatement." Notwithstanding that the definition of a risk of material misstatement includes both inherent risk and control

risk, in the view of the Task Force, changing such a term may raise questions regarding the lack of a requirement to identify “control risks” (the standard currently requires the auditor to identify controls (see paragraph 79 above) and assess control risk (see paragraph 50 of ED-315). It also may further the misconception that the identification of risks of material misstatement can be performed effectively without understanding the entity’s system of internal control. Nonetheless, the Task Force agrees that clarification is needed in the requirement to explicitly state that this identification is ‘based on inherent risk’ (paragraph 45 of ED-315 (see below)).

Identifying and Assessing the Risks of Material Misstatement

45. The auditor shall identify the risks of material misstatement and determine whether they exist at: (Ref: Para. A201–A210)
- (a) The financial statement level, by evaluating whether the identified risks relate more pervasively to the financial statements as a whole, including potentially affecting many assertions; or (Ref: Para. A207)
 - (b) The assertion level for classes of transactions, account balances, and disclosures, ~~taking into account the inherent risk factors~~ based on inherent risk. (Ref. Para. A208)

Matter for IAASB Consideration

7. The IAASB is asked for its views about the proposed changes as described in paragraph 90 above and the provided revised drafting.

Introduction of Significant Classes of Transactions, Account Balances and Disclosures and Relevant Assertions

Summary of Responses (See Nvivo Report 6A and Excel Summary 6B)

Monitoring Group Responses

91. Members of the MG agreed with the introduction of concept of relevant assertion, as well as supporting the threshold of *reasonable possibility* within the definition of relevant assertion. However, it was noted that further guidance would be needed:
- About how to apply the reasonable possibility threshold, with a suggestion that this could be done through linkage to the inherent risk factors.
 - To conclude that there are no relevant assertions for a class of transactions, account balance or disclosure that is material.

Other Responses

92. Overall, there was support from respondents for the introduction of the concepts of ‘SCOTABDS’¹¹ and ‘*relevant assertions*,’¹² Respondents supporting the introduction of the new concepts noted that these

¹¹ ED–315, paragraph 16(j)

¹² ED–315, paragraph 16(h)

concepts would help with scoping the auditor's understanding of the information system as well as scoping of the responses to ROMMs.

93. Notwithstanding the support of the concepts by many respondents, there were respondents who did not support these new concepts or had strong concerns. These respondents, as well as certain others who also generally supported the introduction of the concepts, noted issues with the order in which these are determined (some noting circularity), and that the complexity introduced by these new concepts would result in confusion. Specific concerns were expressed with various aspects of the new definitions, including:

- In relation to the definition of SCOTABDs:
 - The relationship or distinction between the thresholds to reduce audit risk to an '*acceptably low level*'¹³ and a '*reasonable possibility*'¹⁴ of the occurrence of a misstatement.
 - Disagreement with the assertion that the threshold '*reasonable possibility*' is the same as '*more than remote*.' In addition, respondents believe that the '*more than remote*' threshold is too low for purposes of identifying risks of material misstatement, and suggested that '*reasonably possible*' is more appropriate.
 - Whether ED-315 requires the so-called '*drill-down below the assertion level*,' based on application material stating that '*there will be one or more risks of material misstatement that relate to a relevant assertion*.'¹⁵
- In relation to the definition of relevant assertions:
 - Why the auditor's consideration of inherent risk factors was not explicit in the definition.

Task Force Views

94. The Task Force reflected on the comments in relation to the introduction of the SCOTABDs and '*relevant assertions*' concepts, noting that, in principle, respondents agree with the intent to establish more robust risk assessment procedures that will ultimately promote a more effective and focused risk assessment. However, the Task Force fully appreciates that these concepts have introduced an element of complexity (as has been noted in the comment letters to ED-315). To continue to use the concepts, which were broadly supported, the Task Force is of the view that it is important to reconcile the threshold of '*reasonable possibility*' with aspects of the definitions of the *risk of material misstatement* and *detection risk* in accordance with ISA 200.¹⁶
95. For purposes of this discussion, the following sets out notable aspects from relevant definitions:

ISA 200	ED-315 (as proposed)
Risk of material misstatement – The risk that the financial statements are materially misstated prior to	Relevant assertions:

¹³ ISA 200, paragraph 17

¹⁴ Included in the definition of '*relevant assertions*,' see ED-315, paragraph 16(h)

¹⁵ ED-315, paragraph A9

¹⁶ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraphs 13(e) and 13(n)(i)

<p>audit. This consists of two components, described as follow:</p> <p>Inherent risk – The susceptibility of an assertion about a class of transaction, account balance or disclosure <u>to a misstatement</u></p> <ul style="list-style-type: none"> • <u>that could be material</u> (emphasis added), either individually or when aggregated with other misstatements, • before consideration of any related controls. <p>Control Risk – The risk that ...</p>	<ul style="list-style-type: none"> • An assertion is relevant to a class of transactions, account balance or disclosure when the nature or circumstances of that item are such that there is a <u>reasonable possibility of occurrence of a misstatement with respect to that assertion that is material</u> (emphasis added), individually or in combination with other misstatements. • The determination of whether an assertion is a relevant assertion is made before consideration of controls.
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96. The construct of the proposed definition of ‘*relevant assertions*’ was intended to mirror the construct of the definition of risk of material misstatement, before consideration of controls (i.e., based on inherent risk). Accordingly, in identifying a risk of material misstatement, the objective of ED–315 was to only identify those risks of material misstatement where there is ‘*reasonable possibility*’ of occurrence of a misstatement that is material. Without such a filter or threshold, ED–315 may implicitly require the auditor to identify all risks of material misstatement for every assertion, which is clearly not practical. In other words, and in the context of **identifying a risk of material misstatement**, the words ‘*reasonable possibility*’ were designed to clarify the meaning of ‘*could*’ in the definition of inherent risk.¹⁷
97. Given the intent and alignment of the definitions of ‘*risk of material misstatement*’ and ‘*reasonable possibility*’, the threshold of ‘*reasonable possibility*’ also has a relationship to the threshold of ‘*acceptably low level*,’ as included in the definition of detection risk in accordance with ISA 200.

<p>Detection risk:</p> <p>The risk that the procedures performed by the auditor to <u>reduce audit risk to an acceptably low level</u> (emphasis added) will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.</p>

98. Accordingly, further audit procedures are necessary when audit risk is not at an acceptably low level (i.e., when a risk of misstatement exists that could be material).
99. Although being articulated or expressed from a different perspective, it follows that:
- If the auditor identifies a risk of misstatement at the assertion level that does not have a ‘*reasonable possibility*’ of occurring and if it were to occur, to be material, the associated detection risk is at an ‘*acceptably low level*,’ even if no further audit procedures are performed.
 - If the auditor has identified a risk of misstatement that has a ‘*reasonable possibility*’ of occurring, and if it were to occur, to be material then the associated detection risk is not at an ‘*acceptably low level*,’ and further audit procedures are required to reduce such risk to an ‘*acceptably low level*.’
100. In terms of the audit risk model, the auditor is required to identify risks of material misstatement, in order to design and perform further audit procedures, i.e., to reduce detection risk such that audit risk is at an acceptably low level. In introducing the new concept of relevant assertion, the intention had been to help identify those classes of transactions, account balances and disclosures where further audit procedures

¹⁷ ED–315, paragraph 13(n)

would be needed by linking to the ‘*reasonable possibility*’ of the occurrence of a misstatement that is material’. There was no intention to change the audit risk model. However, the Task Force has recognized that the connections explained above are not explicit in ED-315, and has explored changes to address the issues and concerns raised.

101. Based on the support expressed for introducing the concept of relevant assertion, it is the view of the Task Force that consideration should be given to how the ‘*relevant assertion*’ definition could be clarified to help auditors with identifying those SCOTABDs and assertions that require further audit procedures. The Task Force is proposing to address the threshold of ‘*reasonable possibility*’ in a different way (see discussion in paragraphs 106–108 below) and simplify the relevant assertion definition as follows:

Relevant assertions – An assertion about ~~is relevant to~~ a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement. ~~when the nature or circumstances of that item are such that there is a reasonable possibility of occurrence of a misstatement with respect to that assertion that is material, individually or in combination with other misstatements. There is such possibility when the likelihood of a material misstatement is more than remote.~~ The determination of whether an assertion is a relevant assertion is made before consideration of controls.

102. The definition of SCOTABD would then remain unchanged as follows:

Significant class of transactions, account balance or disclosure—a class of transactions, account balance or disclosure for which there is one or more relevant assertions.

103. The Task Force also noted the concerns by respondents relating to the so-called ‘*drill-down*,’ based on application material stating that ‘*there may be one or more risks of material misstatement that relate to a relevant assertion.*’ In the view of the Task Force, the introduction of relevant assertions (and SCOTABD) is intended to focus the auditor on those assertions that have a risk of material misstatement and to clarify that assertions that do not have a risk of material misstatement do not require further audit procedures. Accordingly, the Task Force is of the view that it can be further clarified in the application material that the intention is to not drive the level at which risks of material misstatement are identified; the intention is to clarify the relationship of risk of material misstatement to relevant assertion. Notwithstanding this clarification, in terms of the wording of the revised definition, it has been purposely worded to provide flexibility in its implementation, such that the identification of more than one risk of material misstatement for a particular assertion is still possible.
104. Overall, the change to the definition of relevant assertions better reflects the Task Force’s intention for how relevant assertions would be identified and moves the consideration of the ‘threshold’ from the identification of relevant assertions to the identification of the risks of material misstatement, which better aligns with the Task Force’s thinking as explained in paragraphs 96 to 101 above. The Task Force is also of the view that this approach to relevant assertions is less complex and more understandable.
105. The Task Force has also explored options in the paragraphs that follow regarding retaining and clarifying the ‘*reasonable possibility*’ threshold in relation to the auditor’s identification of the risks of material misstatement. Regardless of the direction taken, the Task Force is of the view that the explanatory material relating to ‘*more than remote*’ should be removed because of the strong disagreement by respondents with equating ‘*reasonable possibility*’ to ‘*more than remote*.’

106. In considering how the ‘reasonable possibility’ threshold can be better explained in terms of existing definitions related to risk of material misstatement within the ISAs, the Task Force came up with various options:

- *Option 1*—Change the definition of the risk of material misstatement in ISA 200 (in the description of inherent risk) to incorporate ‘reasonable possibility’ of the occurrence of a misstatement. This option is the simplest and is the most transparent, but would result in a change to a fundamental definition within the ISAs. Application material would also be added to explain the relationships between the definition of inherent risk and detection risk, as expressed in paragraph 99 above (i.e., if there is a reasonable possibility for a misstatement to occur and be material, audit risk is not at an acceptably low level and further audit procedures are required).

ISA reference:	Description of proposed changes:
ISA 200 para. 13(n)(i)	<p>Risk of material misstatement – The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follow:</p> <ul style="list-style-type: none"> i. Inherent risk – The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that <u>has a reasonable possibility to</u> could be material, either individually or when aggregated with other misstatements, before consideration of any related controls. ii. Control risk – The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure that could <u>has a reasonable possibility to</u> be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal control.
ISA 200 para. 13(n)(i)	<p>Detection risk – The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that <u>has a reasonable possibility to</u> could be material, either individually or when aggregated with other misstatements.</p>

- *Option 2*—do not change the definition of the risk of material misstatement in ISA 200, but add application material to explain the relationship of the ‘could,’ to ‘to the ‘acceptably low level’ concept in the application material of ISA 200 (i.e., if there is a risk that a misstatement could occur and be material, audit risk is not at an acceptably low level and further audit procedures are required). The application material would further explain that for the purpose of the auditor’s identification of risks of material misstatement based on inherent risk, the auditor’s consideration of the likelihood of the misstatement (i.e., ‘could’) is practically applied by considering whether there is a ‘reasonable possibility’ of misstatement to occur and be material. This option would place the concept of ‘reasonable possibility’ in the context of the audit risk model and then clarifications would be made in ED-315 to link to this explanation in ISA 200.

- *Option 3*—make no changes to ISA 200 and clarify in the application material of ED-315 the relationship between ‘reasonable possibility,’ ‘could’ and ‘acceptably low level. This option allows for the audit risk model as articulated in ISA 200 to be clearly unchanged, but also provides practical application guidance to assist in the auditor’s consideration of likelihood when identifying the risks of material misstatement.
107. The Task Force is of the view that because ‘reasonable possibility’ is intended to clarify the meaning of ‘could’ within the definitions in ISA 200, it is best placed in context of those definitions. The Task Force had mixed views about whether Option 1 or 2 would be the preferable approach to making the clarifications, but on balance agreed that the preferable option would be Option 2, as the intent is not to make a fundamental change in the audit risk model, but a change in the definition would be perceived as such. Instead, the Task Force intent is to aid in the practical application of the existing definitions.
108. The Task Force also considered potential implications of formalizing ‘reasonable possibility’ as a threshold for the identification of the risks of material misstatement. Specifically, as with ‘could’ in the extant definition, auditors’ judgment is necessary to identify which risks are risks of material misstatement. The introduction of ‘reasonable possibility’ will not solve the risk that auditor judgments may differ or that auditors’ identification of the risks of material misstatement may not be complete or otherwise imperfect. The Task Force views the documentation requirement in ED-315,¹⁸ that includes documentation of ‘the rationale of significant judgments made’ in identifying risks of material misstatement, as requiring the auditor to document ‘close calls’ in identifying the risks, and therefore providing greater transparency in the audit documentation. In addition, the Task Force considered the role of the ‘stand-back’ requirements in ED-315 and paragraph 18 of ISA 330 (ISA 330.18) as safeguards against imperfect risk assessment (see further discussion below).

Matters for IAASB Consideration

8. In addressing the issues raised relating to relevant assertions and SCOTABDs, in particular those that noted complexity:
- (a) Board members are asked for views about the proposed changes made to the definition of relevant assertions in paragraph 101 and whether further changes are needed to SCOTABDs in paragraph 102.
 - (b) What are the IAASB’s views on the Task Force explanations of the relationship of ‘reasonable possibility’ to the definition of ‘risk of material misstatement’? Does the IAASB agree with the Task Force’s preferred option in paragraph 107, and why, or why not?

Significant Risks

Summary of Responses Relating to Significant Risks (See Nvivo Report 7A and Excel Summary 7B)

Monitoring Group Responses

109. Although supporting the retention of the concept of significant risk, and a change of focus in the definition to be on the criteria for the identification of the risks rather than the audit responses, as well as the use of “close to the upper end” rather than “at the upper end,” concerns were expressed about:

¹⁸ ED-315, paragraph 54(d)

- The determination of what ‘close to the upper end’ means, with a call for more guidance explaining this.
- Those risks that may be identified as significant when there is a low likelihood of the risk occurring.
- The inclusion of application material that suggests that routine, non-complex transactions would likely not give rise to a significant risk (and therefore there would be no requirement to test controls in the current period).
- Interpreting “close to the upper end” to mean that risks are considered significant only in rare circumstances.

Other Responses

110. In determining significant risks:

- As the extant definition focuses the auditor on the response to a significant risk, respondents agreed that the change in the construct of the definition is an improvement, in particular as it now focuses on criteria to determine how to identify such risks on the spectrum of inherent risk. There were respondents, however, that believe that because of the introduction of the spectrum of inherent risk, the concept of significant risk is not needed.
- There was strong disagreement with the aspect of the definition that requires the auditor to consider likelihood ‘or’ magnitude, and recommend that the ‘or’ is replaced with an ‘and.’ Respondents expressed concern that the ‘or’ may cause different interpretations and have unintended consequences, such as an unrealistic increase in the number of significant risks identified, in particular where the likelihood of occurrence of misstatement is low.
- Respondents expressed concern with the meaning or scope of ‘close to the upper end of the spectrum of inherent risk.’ Respondents appreciate that the determination of a significant risk is a ‘matter of professional judgment,’¹⁹ however the notion that ‘a higher risk assessment could result from a lower likelihood but a very high magnitude,’²⁰ caused concern that the guidance is too vague and may be interpreted differently. It was also noted that there may be confusion with ‘higher assessed risks of material misstatement’ in ISA 701.²¹
- Concern was raised that more risks would be scoped in that may not require the audit attention attributed to a significant risk.

Task Force Views

111. The Task Force has reconsidered the definition of significant risk, and in particular, the concern that the consideration of ‘*likelihood of misstatement occurring*’ or ‘*the magnitude of potential misstatement*,’ may have unintended interpretations and consequences. The Task Force agrees with the notion that there may be unintended consequences. Taking into account that the objective of the revised definition is to drive more consistency in the determination of significant risks, the Task Force believes that in light of the many concerns raised, the wording should be changed to ‘*likelihood of misstatement occurring*’ and ‘*the*

¹⁹ ED–315, paragraph A229

²⁰ ED–315, paragraph A222

²¹ ISA 701, *Communicating Key Audit Matters in the Auditor’s Report*

magnitude of potential misstatement.’ In the view of the Task Force this will also help to clarify the meaning of “close to the upper end” of the spectrum of inherent risk.

112. The Task Force also considered whether, or how, to respond to requests for further guidance in determining when an inherent risk is assessed as ‘*close to the upper end of the spectrum of inherent risk.*’ In its deliberations, the Task Force expressed caution to add further guidance or criteria that may be interpreted too narrowly. For example, it should be recognized that:

- The application material explains that the determination of which of the assessed inherent risks are close to the upper end of the spectrum of inherent risk, is a matter of **professional judgment**, unless the risk is of a type specified to be treated as a significant risk in accordance with the requirements of another ISA.²²
- Notwithstanding that the introduction of the inherent risk factors is expected to aid consistency in risk assessments, which should contribute towards greater consistency in significant risks, the degree to which the inherent risk factors affect the likelihood and magnitude of potential misstatements may be vastly different from one entity to another, or from one period to another. For example, where there is change the inherent risk factor may drive the risk assessment such that the risk is identified as a significant risk in the year of change, but not in the years thereafter.

113. Although cautious to add further explanatory material in relation to the determination of ‘*close to the upper end of the spectrum of inherent risk,*’ the Task Force believes that the proposed change in the definition of significant risk will be helpful in making this determination (see paragraph 111 above). This change will also help those respondents’ who have the view that risks that should not be significant risks may be scoped in inadvertently.

114. The Task Force has agreed that it would be useful to add application material to clarify that in rare circumstances there may be an entity that does not have a significant risk, while in other situations there may be multiple significant risks identified, as well as clarify that routine, non-complex transactions are not likely to give rise to significant risks when they do not involve subjectivity (e.g., routine processing related to trade receivable not likely to be a significant risk, but the valuation of trade receivables and determining impairment could rise to the level of a significant risk).

Matters for IAASB Consideration

9. The IAASB is asked for its views on:

- (a) Changing the definition of significant risk as explained in paragraph 111 above.
- (b) Retaining the description of significant risks as being “close to the upper end of the spectrum of inherent risk” but providing further application material to support a more consistent application.

Stand-Back and ISA 330.18

Summary of Responses Relating to Stand-Back and ISA 330.18 (Nvivo Report 8A and Excel Summary 8B)

115. In the Explanatory Memorandum to ED-315, respondents were asked about their views about the proposed stand-back requirement in ED-315²³ and the revisions to paragraph 18 of ISA 330, and more

²² ED-315, paragraph A229

²³ ED-315, paragraph 52

specifically, whether either or both requirements should be retained. A summary of the responses are noted below:

Respondent group	No specific response to question		No standback and no 330 para. 18		Retain both the standback and 330 para. 18		Retain ONLY 330 para. 18		Retain ONLY standback in 315	
	Count	%	Count	%	Count	%	Count	%	Count	%
Totals (72)	20	28%	4	6%	27	38%	8	11%	13	18%
Monitoring Group	2				2					
Regulators & Oversight Auth.	3				2					
Accounting Firms	1		3		1		2		4	
NSS	1				6				4	
Member Bodies / Prof Org	5		1		10		6		5	
Public Sector	3				3					
Individuals and Others	4				3					
Academics	1									

Monitoring Group Responses

116. One MG member explicitly supported the introduction of the stand-back, but also highlighted that this should be supported by a stand-back in ISA 330. In addition, this MG member called for more guidance about how this evaluation should be, as well as making a stronger link to paragraph 18 of ISA 330 (which the MG member highlighted as being an important paragraph).
117. MG members supported keeping paragraph 18 of ISA 330, subject to concerns noted. One MG member has noted concerns about the requirement to perform substantive procedures in paragraph 18 of ISA 330 does not require substantive tests for *all* relevant assertions, for material classes of transactions, account balances or disclosures. It was added that this could suggest that a relevant assertion may be identified for which there are no substantive procedures required.

Other Responses

118. There were respondents who agreed that both the stand-back and ISA 330.18 should be retained, with respondents adding that it was important to keep both as they served different purposes.
119. Comments made by respondents who did not agree with the stand-back requirement in ED–315 included:
- The requirements and guidance in ED-315 drive a robust, risk-based approach that allows the auditor to better tailor procedures based on the reasons for the assessed risks of material misstatement. As a result, the auditor is able to identify the classes of transactions, account balances and disclosures for which reasonable possibility of material misstatement exists. The inclusion of the stand-back requirement will result in additional focus on classes of transactions, account balances and disclosures that were already determined by the auditor not to be qualitatively or quantitatively material, with no measurable increase in audit quality. Respondents also noted that robust procedures negate the need for the stand-back.
 - The inclusion of the stand-back requirement adds complexity to the proposed standard.

- The iterative nature of the proposed standard already requires the auditor to re-assess the conclusions of the auditor's risk assessment, based on evidence that may be inconsistent with the audit evidence on which the auditor originally based the identification of risks of material misstatement.²⁴
 - That the stand-back is performed too early in the audit and may become boilerplate on recurring audits.
120. Those in favor of retaining the stand-back noted that this would drive an evaluation of the completeness of the SCOTABDs. Some of the respondents who favored the stand-back only did so because they either believed that the stand-back in the standard was more valuable (and in some cases it was noted that 330.18 is not needed) or noted that the two stand-backs were not clearly distinguishable and may therefore cause confusion.
121. Those in favor of keeping paragraph 18 of ISA 330 highlighted that this was the appropriate 'backstop' against a flawed risk assessment.
122. Those not in favor of retaining paragraph 18 of ISA 330 noted that it was not needed because of the new stand-back in ED-315, while others noted that it undermines the risk assessment process. It was also noted that there is no need for a safety net, in particular as this very seldom picked anything up.
123. Mixed views were expressed in relation to the description of material as being '*quantitative*' and '*qualitative*' in the stand-back. Those respondents who supported the additional wording argued that it is a helpful reminder that materiality includes both quantitative and qualitative aspects. Other respondents suggested these criteria are:
- Unnecessary as it is implicit to the definition of materiality.
 - Adding to the complexity of the standard as it creates translation challenges.
- One respondent had the view that this should relate to performance materiality and not materiality.
124. Questions were asked about the extent of the documentation of the evaluations, and confusion between the use of the term 'significant' and 'material' were noted by respondents variously.

Task Force Views

125. The views by respondents on whether to retain the stand-back in paragraph 52 of ED-315, paragraph 18 of ISA 330, or both, were very mixed. On balance, the Task Force has agreed that both should be retained and changes proposed to alleviate some of the concerns that have been noted in relation to each:
- The references to 'qualitative' and 'quantitative' in the context of materiality will be removed in both the stand-back in paragraph 52 of ED-315 and paragraph 18 of ISA 330 (in effect, ISA 330 paragraph 18 reverts back to the wording of the extant requirement).
 - Revise paragraph 52 of ED-315 to clarify that it is classes of transactions, account balances and disclosures that are material (not significant as those would already have been addressed) that are subject to further consideration in this paragraph. As it is proposed that the definition of relevant assertion has been changed to relate to risks of material misstatement, the change will also be made here. Proposed drafting is set out below.

²⁴ ED-315, paragraph 53

Classes of Transactions, Account Balances and Disclosures that are Not Significant, but which are Material

52. For material classes of transactions, account balances or disclosures that have not been identified as significant classes of transactions, account balances or disclosures ~~the auditor shall:~~ (Ref: Para. A240–A242)

~~(a) Identify the classes of transactions, account balances and disclosures that are quantitatively or qualitatively material, and that have not been identified as significant classes of transactions, account balances or disclosures in accordance with paragraph 46; and~~

~~eEvaluate whether the auditor's conclusion that there are no relevant assertions (that is, no related risks of material misstatement) for these classes of transactions, account balances and disclosures remains appropriate.~~

126. The Task Force further considered whether substantive procedures for *all* relevant assertions, for material classes of transactions, account balances or disclosures, in paragraph 18 of ISA 330 is required, but agreed that no further changes was needed beyond the proposed application material²⁵ that makes it clear that the auditor would consider the most appropriate assertion when designing substantive audit procedures. In particular, requiring substantive procedures for all *relevant* assertions would have the effect of actually requiring *no* substantive procedures, because by definition, if there are no identified risks of material misstatement related to a class of transactions, account balance or disclosure, there are no relevant assertions.

Matters for IAASB Consideration

10. The IAASB is asked:

- (a) For its views on retaining both the stand-back in paragraph 52 of ED-315, and paragraph 18 of ISA 330, subject to the changes noted, in light of the responses that have been received.
- (b) Whether it agrees with the removal of 'qualitative' and 'quantitative' in paragraph 18 of ISA 330.
- (c) For views about the redrafted paragraph 52 of ED-315 as illustrated in paragraph 125 above.

Spectrum of Inherent Risk

Summary of Comments Related to Spectrum of Inherent Risk (Nvivo Report 9A and Excel Summary 9B)

Monitoring Group Responses

127. Two MG members explicitly supported the introduction of the spectrum of inherent risk, however called for:

- A supporting requirement to assess where each risk of material misstatement belongs on the spectrum.
- Further guidance to appropriately promote the consistent application by auditors.

²⁵ Conforming Amendments to ED-315, paragraph A42a of ISA 330

Other Responses

128. Respondents were broadly supportive of the introduction of the spectrum of inherent risk, noting that it enhances the identification and assessment of risks of material misstatement and should therefore drive greater consistency, as well as reinforce the notion that not all risks are the same (i.e., not just a binary assessment between significant and non-significant). It was also noted that the spectrum of inherent risk would help with the identification of significant risks (see above), although there were respondents who noted that the introduction of the spectrum of inherent risk made the concept of significant risk redundant.
129. Notwithstanding the support, there was a call for more in the standard as the spectrum of inherent risk is not defined and not dealt with clearly enough elsewhere. It was also noted that further guidance about the spectrum was needed (in particular about where on the spectrum a risk could be), with suggestions that an illustration would be helpful. Respondents also noted that it should be described using simpler language, in particular for translation purposes.
130. Concerns raised about the introduction of the spectrum of inherent risk included that:
- It would not necessarily result in a consistent assessment of risks.
 - It would not bring about a change in practice and was therefore not really needed.
 - It is difficult to apply, or was not sufficiently explained in ED-315, with a call for more practical guidance.
 - It may exacerbate the underestimation of where a risk may lie on the spectrum.
 - It was not clear what the relationship between materiality and magnitude is.

Task Force Views

131. The Task Force is of the view that there is sufficient support for the introduction of the spectrum of inherent risk, and proposes keeping the concept but further considering other ways to address the concerns that have been noted.
132. In further considering whether changes are needed, it remains the view of the Task Force at this stage that it isn't necessary to include a supporting requirement to assess where each risk of material misstatement belongs on the spectrum (i.e., include the spectrum of inherent risk in the requirements of the standard) as the concept is meant to reinforce that the assessment of risks is scaled. The Task Force also believes that the implementation of the spectrum occurs through firm methodologies and does not believe it is appropriate or practical to prescribe a scale that must be used in all audits.
133. With regard to further explaining the spectrum of inherent risk in the application material, the Task Force intends enhancing the application material to make clear that where a risk falls on the spectrum of risk is a matter of professional judgment, rather than a matter capable of precise measurement. In addition, the proposed change clarifying that significant risks are "close to the upper end" (see paragraph 112 above), the Task Force believes that using a term such as 'upper end' will also assist illustrate a scale or spectrum.

Matter for IAASB Consideration

11. The IAASB is asked for its views on the matters set out in paragraphs 131–133 above.

‘Sufficient Appropriate Audit Evidence’ for Risk Assessment Procedures

Summary of Comments Related to Sufficient Appropriate Audit Evidence (Nvivo Report 10A and Excel Summary 10B)

Monitoring Group Responses

134. One MG member noted concern about using “sufficient appropriate audit evidence” as the purpose or objective of risk assessment procedures as this may cause confusion with how the term is used with regard to the relevance and reliability of audit evidence needed to support the audit opinion. In addition it was noted that this may cause unnecessary work where efforts could be focused elsewhere.

Other Respondents

135. Although other respondents were supportive of the principle of obtaining an appropriate base of evidence for risk assessment, concern was noted about linking this to sufficient appropriate audit evidence. Rather, it was noted that this term was often used in the context of collecting evidence that was sufficient and appropriate (ISA 500)²⁶ on which to draw conclusions and report, not relating to risk identification and assessment. Others noted that they did not believe that this would necessarily encourage professional skepticism, or would not be effective.
136. Those respondents who did support the use of “sufficient appropriate audit evidence” as the basis for the identification and assessment of the risks of material misstatement noted that this would encourage the exercise of professional skepticism.

Task Force Views

137. In light of the comments of the respondents, on balance the Task Force agreed that the intention is not to require a work effort that is not commensurate with the purpose of performing risk assessment procedures. Accordingly the Task Force proposes to change the purpose of risk assessment procedures in paragraph 17 of ED-315 to be ‘to obtain audit evidence that provides an appropriate basis for’ the identification and assessment of the risk of material misstatement. In making the change, the Task Force is also mindful that paragraph A10 of ISA 500 notes that risk assessment procedures provide audit evidence and therefore the link to audit evidence is still made. The Task Force has also added a secondary purpose of risk assessment procedures to provide an appropriate basis for the design of further audit procedures in accordance with ISA 330, which further strengthens the linkage between ED-315 and ISA 330.

Matter for IAASB Consideration

12. The IAASB is asked for its views on the matters set out in paragraph 137 above.

V. Scalability and Proportionality of Application Material

138. In addition to **Section II** of this paper setting out matters for consideration relating to addressing some of the broader issues and concerns relating to complexity and understandability, and scalability and proportionality, of the requirements, the Task Force has also been mindful that broader changes will be needed to the application material to illustrate the scalability and proportionality of the standard.

²⁶ ISA 500, *Audit Evidence*

139. The following sets out the basic principles for an approach to making changes to the Application Material to focus on the scalability and proportionality of the application material. In addition, this approach will also likely help with the concerns that have been raised in relation to complexity and understandability. As the Task Force progresses the changes to ED-315, in particular in areas where there is a view that new application material may be needed, the Task Force will be mindful of the principles set out below, as well as the volume that is being added.
140. Depending on the outcome of the discussions with the IAASB about the overall approach to the changes to the requirements, further changes may also be needed to the application material arising from how the requirements are drafted.
141. Some of the more specific matters that the Task Force believes need to be addressed include:
- Long paragraphs.
 - Long, and sometimes complex, sentences.
 - Volume of the application material – is this all needed in the standard?
 - Repetition.
 - Consistency of use of terms.
142. In considering what can be done to address these issues that have been raised, the Task Force intends to review all of the application material applying the following principles:
- Address, as necessary, long paragraphs (for example by breaking them up) as well as long (and complex) sentences to provide clarity. Where possible, the sentences will be redrafted using simpler and more understandable language.
 - Use bulleted lists where possible to make it easier to read.
 - Reduce cross referencing within the standard.
 - Consider consistency in the way that each section is drafted.
 - Consider whether the material is appropriate to keep in the application material, or consider whether it can be moved to an Appendix (which still forms part of the standard) or is better suited to some form of implementation guidance. For example, if the explanatory material relates to the entity then this can form part of an Appendix, but if the matters relate to audit considerations these should be kept within the body of the application material.
 - Further explore whether the application material may be presented in a clearer, simpler way. For example:
 - (i) Show examples in a box to distinguish them from the explanatory material.
 - (ii) Separate the ‘scalability and proportionality’ considerations into a separate section. As part of this, the Task Force will also need to consider how this is presented, as respondents had raised many concerns about the use of the term “smaller and less complex entities” in ED-315 (although this will likely change to be “less complex entities” to be consistent with the way that the term is being used in the Less Complex Entity (LCE) project). In addition, concern had also been raised that the current focus on ‘scaling down’ did not present the full range of scalability (i.e., there was no focus on ‘scaling up’). The current work of the LCE Working Group may also help inform how these matters are presented within the standard.

143. The following sets out an example of revised application material using the principles set out above, but does not include the Task Force's consideration about specific changes that may be needed to the application material presented based on the specific issues raised by respondents. Accordingly, the principles have been applied to existing application material for illustration purposes only. The Task Force plans to progress the redrafting of the application material based on the IAASB's feedback on this illustration and present the revised application material, including updates for changes in requirements and to address specific comments from respondents, for the June 2019 meeting.

Example Redrafted Application Material

The Entity's Risk Assessment Process (paragraphs A115–A121 of ED-315)

(Shown as marked to ED-315)

A115. ~~The entity's risk assessment process is an iterative process for identifying and analyzing risks to achieving the entity's objectives, and forms the basis for how management or those charged with governance determine the risks to be managed.~~

A115A. [new paragraph explaining the purpose of obtaining the understanding of this component of the system of internal control]

Scalability paragraphs

A116. The extent to which an entity's risk assessment process is formalized may vary. Some entities, including ~~smaller and~~ less complex entities, and particularly owner-managed entities, may not:

- ~~Have established a structured risk assessment process;~~ or
- ~~Have a the risk assessment process may not be documented risk assessment process;~~ or
- ~~Performed risk assessment on a regular basis.~~

A116A. Irrespective whether the risk assessment process is formally established or not, the auditor may still obtain the required understanding ~~required by paragraph 29 about how the entity identifies risks relevant to financial reporting and how these risks are addressed~~ through observation and inquiry.

Understanding the Entity's Risk Assessment Process (Ref: Para. 29)

A117. ~~In order to understand how management and those charged with governance have identified business risks relevant to financial reporting objectives, and have decided about actions to address those risks, m~~ Matters the auditor may consider include how management or, as appropriate, those charged with governance have:

- Specified objectives with sufficient clarity to enable the identification and assessment of the risks relating to these objectives;
- Identified the risks to achieving the entity's objectives, and analyzed these risks as a basis for determining how the risks should be managed;
- Considered the potential for fraud when considering the risks to achieving the entity's objectives; and

- Identified and evaluated changes that could significantly affect the entity's system of internal control.

~~As explained in paragraph A59, n~~ Not all business risks identified by management and those charged with governance give rise to risks of material misstatement.

A118. ~~The nature, timing and extent of the auditor's risk assessment procedures to obtain the understanding of the entity's risk assessment process may vary to the extent necessary, to provide an appropriate basis for the required evaluation in paragraph 31.~~

A119. Understanding the risks arising from the entity's use of IT identified by the entity, as well as how these risks have been addressed, is an important input to the auditor's identification of risks arising from the use of IT ~~in accordance with paragraph 41~~. It may also help the auditor understand the nature and extent of automated processes, and the data, used in controls that may be relevant to the audit.

Evaluating the Appropriateness of the Entity's Risk Assessment Process (Ref: Para. 31)

A120. ~~[Moved below] Whether the entity's risk assessment process is appropriate to the circumstances of the entity, including its nature, size, and complexity, is a matter of the auditor's professional judgment. For example, in some smaller and less complex entities, and particularly owner-managed entities, an appropriate risk assessment may be performed through the direct involvement of management or the owner-manager (e.g., the manager or owner-manager may routinely devote time to monitoring the activities of competitors and other developments in the market place to identify emerging risks that may affect how the entity applies the requirements of the applicable financial reporting framework related to the entity's ability to continue as a going concern).~~

A121. When the auditor determines, ~~in accordance with paragraph 31(b)~~, that a control deficiency exists ~~related to the entity's risk assessment process~~, the auditor is required to determine, ~~in accordance with paragraph 43~~, whether any such deficiency constitutes a significant control deficiency.²⁷ Whether the absence of an appropriate risk assessment process represents a significant control deficiency is a matter of the auditor's professional judgment. Circumstances that may indicate a significant control deficiency exists include matters such as:

- The absence of a risk assessment process when such a process would ordinarily be expected to have been established; or
- ~~Evidence of an ineffective risk assessment process, which may be the case~~ When the entity's risk assessment process has failed to identify an expected risk of material misstatement when it would be expected the risk assessment process would have identified the risk.

Scalability Paragraph

A121A. Whether the entity's risk assessment process is appropriate to the circumstances of the entity, including its nature, size, and complexity, is a matter of the auditor's professional judgment.

Example:

In some less complex entities, and particularly owner-managed entities, an appropriate risk assessment may be performed through the direct involvement of management or the owner-manager. For example, the manager or owner-manager may routinely devote time to monitoring the activities of competitors and other developments in the market place. Such activities may help to identify emerging risks related to the entity's ability to continue as a going concern).

Matter for IAASB Consideration

13. The IAASB is asked for its views on how the Task Force proposes to approach changes to the application material to address issues related to scalability and proportionality, and complexity and understandability, as set out in paragraphs 138–143 above. Are there any other suggestions about how this can be done?

²⁷ See Paragraph 43

Appendix 1

List of Respondents to ED-315

NOTE: MEMBERS OF THE MONITORING GROUP ARE SHOWN IN **BOLD** BELOW.

#	Abbrev.	Respondent	Region
Regulators and Oversight Authorities (9)			
1.	BCBS	Basel Committee on Banking Supervision	GLOBAL
2.	CEAOB	Committee of European Auditing Oversight Bodies	EU
3.	CPAB	Canadian Public Accountability Board	NA
4.	IAASA	Irish Auditing & Accounting Supervisory Authority	EU
5.	IAIS	International Association of Insurance Supervisors	GLOBAL
6.	IFIAR	International Forum of Independent Audit Regulators	GLOBAL
7.	IOSCO	International Organization of Securities Commissions	GLOBAL
8.	IRBA	Independent Regulatory Board for Auditors	MEA
9.	UKFRC	Financial Reporting Council – UK	EU
National Auditing Standard Setters (11)			
10.	AASB-ICAI	Auditing and Assurance Standards Board of the Institute of Chartered Accountants India	MEA
11.	AUASB	Australian Auditing and Assurance Standards Board	AP
12.	CAASB	Canadian Auditing and Assurance Standards Board	NA
13.	CNCC-CSOEC	Compagnie Nationale des Commissaires aux Comptes and the Conseil Supérieur de l'Ordre des Experts-Comptables	EU
14.	HK-CPA	Hong Kong Institute of CPAs	AP
15.	IDW	Institut der Wirtschaftsprüfer	EU
16.	JICPA	The Japanese Institute of Certified Public Accountants	AP
17.	MAASB	Auditing and Assurance Standards Board of Malaysian Institute of Accountants	AP
18.	NBA	Nederlandse Beroepsorganisatie van Accountants	EU
19.	NBAT	National Board of Accountants Tanzania	MEA
20.	NZAASB	New Zealand Auditing and Assurance Standards Board	AP
Accounting Firms (11)²⁸			
21.	ANA	Altaf Noor Ali Chartered Accountants	MEA
22.	BDO*	BDO International Limited	GLOBAL

²⁸ Forum of Firms members are indicated with a *. The Forum of Firms is an association of international networks of accounting firms that perform [transnational audits](#).

23.	BT*	Baker Tilly LLP	GLOBAL
24.	CI*	Crowe International	GLOBAL
25.	DTT*	Deloitte	GLOBAL
26.	EY*	Ernst & Young Global Limited	GLOBAL
27.	GTI*	Grant Thornton International Ltd	GLOBAL
28.	KPMG*	KPMG IFRG Limited	GLOBAL
29.	MNP	MNP LLP	NA
30.	PwC*	PWC International	GLOBAL
31.	RSM*	RSM International	GLOBAL
Public Sector Organizations (6)			
32.	AGA	Auditor-General of Alberta	NA
33.	AGC	Auditor-General of Canada	NA
34.	AGM	Auditor-General Montreal	NA
35.	GAO	US Government Accountability Office	NA
36.	SNAO	Swedish National Audit Office	EU
37.	WAO	Wales Audit Office	EU
Member Bodies and Other Professional Organizations (27)			
38.	ACCA-CAANZ	Association of Chartered Certified Accountants - Chartered Accountants Australia and New Zealand	GLOBAL
39.	AE	Accountancy Europe	EU
40.	AICPA	American Institute of Certified Public Accountants	NA
41.	CAQ	Center for Audit Quality	NA
42.	CIPFA	Chartered Institute of Public Finance & Accountancy	EU
43.	CPAA	CPA Australia	AP
44.	EFAA	European Federation of Accountants and Auditors for SMEs	EU
45.	FAAPA	Finnish Association of Authorised Public Accountants	EU
46.	FACPCE	Federación Argentina de Consejos Profesionales de Ciencias Económicas (Argentine Federation of Professionals Councils of Economic Sciences)	SA
47.	FSR	FSR Danske Revisorer	EU
48.	IAAA	Interamerican Accounting Association	SA
49.	IBRACON	Instituto dos Auditores Independentes do Brasil	SA
50.	IBR-IRE	Institut des Réviseurs d'Entreprise / Instituut van de Bedrijfsrevisoren	EU
51.	ICAEW	Institute of Chartered Accountants in England and Wales	EU
52.	ICAG	Institute of Chartered Accountants of Ghana	MEA

53.	ICAP	Institute of Chartered Accountants of Pakistan	MEA
54.	ICAS	Institute of Chartered Accountants Scotland	EU
55.	ICAZ	Institute of Chartered Accountants of Zimbabwe	MEA
56.	IIA	Institute of Internal Auditors	Global
57.	IPA	Institute of Public Accountants	AP
58.	ISCA	Institute of Singapore Chartered Accountants	AP
59.	MICPA	Malaysian Institute of Certified Public Accountants	AP
60.	NYSS CPA	New York State Society of CPAs	NA
61.	PAFA	Pan African Association of Accountants	MEA
62.	SAICA	South African Institute of Chartered Accountants	MEA
63.	SMPC	IFAC Small and Medium Practices Committee	GLOBAL
64.	WPK	Wirtschaftsprüferkammer	EU
Individuals and Others (7)			
65.	CAATAS	Chartered Accountants Academy and Training and Advisory Services	MEA
66.	FRI	FocusRoi Inc.	NA
67.	LD	Lynessa Dias	NA
68.	MFC	Miguel Fonseca Cortina	SA
69.	RW	Dr Richard Wittsiepe	EU
70.	SDAH	S Dianne Azoor Hughes	AP
71.	UNSW	UNSW Research Network	AP
Academics (1)			
72.	AAA	American Accounting Association	NA

Appendix 2

Listing of Nvivo Reports and Excel Summary Spreadsheets

Description:	Question # in Explanatory Memorandum	NVivo Word Report Reference:	Excel Summary Sheet Reference:
Scalability/Proportionality	2	1A	1B
Complexity	1(a)	2A	2B
Understanding the system of internal control	5(a)	3A	3B
Controls relevant to the audit	5(b)	4A	4B
Separate assessment of inherent and control risk	6(a)	5A	5B
Relevant assertions	6(d)	6A	6B.1
SCOTABD	6(d)	6A	6B.2
Significant risk	6(e)	7A	7B
Standback and ISA 330 para. 18	8	8A	8B.1
Qualitatively and quantitatively material	10	8A	8B.2
Spectrum of inherent risk	6(c)	9A	9B
Sufficient appropriate audit evidence for risk assessment procedures	4	10A	10B

ISA 315 Task Force and Details of Meetings

Task Force Members and Activities Including Outreach

1. The following sets out the activities of the Task Force, including outreach with others and coordination with other IAASB Task Forces and Working Groups relating to the ISA 315 (Revised) project, since December 2018. The Task Force consists of the following members:
 - Fiona Campbell – Chair (supported by Denise Weber)
 - Megan Zietsman (until February 2019) (supported by Melissa Bonsall)
 - Karin French
 - Marek Grabowski (supported by Josephine Jackson)
 - Susan Jones
 - Kai Morten Hagen

Further information about the project can be found [here](#).

Task Force Activities since the December 2018 IAASB Discussion

2. The ISA 315 Task Force has met once in person and held 3 teleconferences since the last IAASB discussion in December 2018.

Outreach

3. The Deputy Chair of the IAASB provided an update on ISA 315 (Revised) Exposure Draft to members of the Basel Committee's Audit Subgroup. In particular, Ms. Zietsman highlighted:
 - Broad messages of concern and support based on the feedback received from respondents to the exposure draft.
 - The initial views of the Task Force to address concerns raised by the Board and respondents.