

Responses to ED-315¹
Comments on 'Controls Relevant to the Audit'
NVivo Report 4A
(FOR REFERENCE)

Monitoring Group

06. IFIAR (Global)

We believe paragraph 39(e) provides important direction to the auditor in identifying those controls that are relevant to the audit. As a result we recommend moving this criterion to the beginning of the paragraph to direct the auditor to start with a broader perspective on determining the controls relevant to the audit. Further we recommend removing the phrase “in the auditor’s professional judgment” from the criterion in paragraph 39 (e) because we believe that the application of professional judgement is implicit in this requirement.

07. IOSCO

Further, we believe that paragraph 39(e) may hinder the scalability of the standard as it appears to encompass a very wide range of controls as relevant to the audit. Specifically, we believe the language in paragraph 39(e)(i) might result in all controls related to relevant assertions of significant classes of transactions, account balances, and disclosures being concluded to be relevant to the audit. As we do not believe this was the Board's intention, we'd suggest revisiting this paragraph and considering whether it potentially is too all-encompassing.

Regulator and Oversight Authorities

08. IRBA (South Africa)

Reference 1:

We further suggest that the IAASB define, in paragraph 16 of ED-315, what is meant by “*controls relevant to financial reporting*” and “*controls relevant to the audit*”.

Reference 2:

- The requirements related to the auditor’s identification of controls relevant to the audit have been appropriately enhanced and clarified.
- We agree that it is clear how controls relevant to the audit are identified, but encourage the IAASB to enhance the application material with respect to scalability.
- Paragraphs A104 and A166 of ED-315, which deal with controls relevant to the audit being primarily from the control activities component, should be linked back to paragraph 36 of ED-315 that requires the auditor to evaluate the design and implementation of the information system controls relevant to financial reporting. This is because our understanding is that paragraph 36 of ED-315 (information system and communication) and paragraph 42 of ED-315 (control activities) are the requirements for direct controls and should thus be cross-referenced.
- We also recommend that the application material should explain that controls relevant to the audit, as per paragraph 39 of ED-315, are at the assertion level as controls relevant to the audit are primarily from the control activities component of the system of internal control. Control activities are direct

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

controls that are designed to prevent, or to detect and correct, misstatements at the assertion level for the classes of transactions, account balances and disclosures in the entity's financial statements.

- Further, the IAASB should consider including application material to illustrate when indirect controls can be identified to be controls relevant to the audit, even if this is a rare circumstance.
- The distinction between direct and indirect controls is important for purposes of identifying controls relevant to the audit, as a result, we propose that the IAASB define these two terms as part of paragraph 16 of ED-315 as follows:
 - Direct controls: Controls that are designed to prevent, or to detect and correct, misstatements at the assertion level for the classes of transactions, account balances and disclosures in the entity's financial statements.
 - Indirect controls: Controls that are typically not precise enough to prevent, or detect and correct, misstatements at the assertion level and instead may have an indirect effect on the likelihood that a misstatement will be detected or prevented on a timely basis.

09. UK Financial Reporting Council

Overall, we support the enhancements to the requirements and application material related to the auditor's identification of controls relevant to the audit. However, we believe that information system controls are always 'controls relevant to the audit' because:

- Controls (i.e. policies and procedures) that define the flows of information relevant to financial reporting (information system controls) are always relevant to an audit of financial statements.
- The auditor is required to evaluate whether the information system controls are designed effectively and determine whether the controls have been implemented in accordance with ED-315 paragraph 36. Only when controls are relevant to the audit is the auditor required to evaluate the design and implementation of controls (in accordance with ED-315 paragraph 42).

Although the requirement in ED-315 paragraph 36, along with related application material, implies that information system controls are also 'controls relevant to the audit', we are concerned that excluding 'information system controls' from the list of 'controls relevant to the audit', set out in ED-315 paragraphs 39(a)-(e) is confusing. This ambiguity may result in information system controls not being tested sufficiently, and undue reliance being placed upon them. As a result, we believe that the IAASB should include information system controls in the comprehensive list of controls relevant to the audit in ED-315 paragraph 39.

National Standard Setters

11. Australian A&A Standards Board

The AUASB considers that ED 315 paragraph 39 (and paragraphs A166 and A167) provides clarity on the identification of controls relevant to the audit, including clarifying that most controls that are relevant to the audit will be direct controls in the Information System and Communication and Control Activities components. We recommend that the IAASB clarify the intention of 39(e), or consider removing this, as we consider that the controls relevant to the audit are captured appropriately in the preceding elements of this paragraph.

We consider that paragraphs A166 and A167 do provide sufficient clarity that based on the complexity and size of an entity an auditor may conclude that the only relevant controls are those over journal entries if they do not plan to rely on any of the other controls. However, some of our stakeholders have expressed concern that for some less complex entities the controls over journals may not be documented and are difficult to test. We consider paragraph A167 should include guidance to address this scenario.

We also recommend the following amendments:

- Paragraph 39 (a) "... procedures alone ~~do~~ may not provide sufficient..."
- Paragraph 40 (d) "... substantive procedures alone ~~do~~ may not provide sufficient ..."

12. Canadian AASB

Reference 1:

We believe, however, that for ED-315 to promote a more consistent process for the identification and assessment of the risks of material misstatement, further improvements are needed. The results of field testing showed that many Canadian practitioners had significantly different interpretations of certain aspects of the proposals. In particular, we are concerned about the following:

- *Controls relevant to the audit in accordance with paragraph 39(e)* - There are two very different interpretations of the requirement in paragraph 39(e) to identify controls relevant to the audit that, in the auditor's professional judgment, would enable the auditor to identify and assess the risks of material misstatement. Some practitioners had the view that many controls would be identified as relevant to the audit (i.e., all "in scope" or "significant" financial statement line items would have controls relevant to the audit identified under this requirement), while others said they would rarely identify any controls under the requirement in paragraph 39(e). The different interpretations would result in a significant inconsistency in practice. We suggest the IAASB clarify its expectation on paragraph 39(e). [Please see our response to Q5b for further details].
- *Lack of clarity in the "information system and communication" component of internal control (paragraphs 35-36)* – in particular the extent of understanding required; the controls the auditor would identify and how these controls would differ from those identified under the requirement to perform design and implementation procedures over controls relevant to the audit (paragraph 42); and the impact on the audit when the methods and controls used by the entity to generate information are weak. [Please see our response to Q5c for further details].

Reference 2:

While we believe the requirements related to the auditor's identification of controls relevant to the audit are improved, it's clear that practitioners have very different interpretations of paragraph 39(e). Results of field testing indicated:

- Some practitioners said they would identify a lot of controls relevant to the audit under the requirement in paragraph 39(e) that asks the auditor to identify controls that, in the auditor's professional judgment, would enable the auditor to identify and assess risks of material misstatement at the assertion level. The inclusion of paragraph 39(e)(i) led them to believe all "in scope" or "significant" financial statement line items would have controls relevant to the audit identified under this requirement.
- On the other hand, other practitioners said they would not necessarily identify any controls relevant to the audit under paragraph 39(e), as they interpreted it as allowing them to use professional

judgment in deciding when controls other than the situations addressed by paragraph 39(a)-(d) would be relevant to the audit.

These two interpretations would result in a significant inconsistency in practice. We suggest the IAASB clarify whether the former or latter interpretation (or another expectation) is intended.

We believe the interpretation in (ii) above is correct. If so, an example that could be added in the application material as another bullet in paragraph A179 is to consider whether the auditor would design a different response to the risk if there were controls in place to mitigate the risk. If so, then controls should be identified as relevant to the audit under paragraph 39(e). An example of when the auditor would not design a different response (and therefore would not have identified any controls under paragraph 39(e)) would be if the auditor intended to obtain audit evidence from events occurring up to the date of the auditor's report to respond to the risk of material misstatement at the assertion level relating to an accounting estimate.

13. CNCC-CSOEC

- We agree that auditor's understanding of each component of the entity's system of internal control is a prerequisite of assessing control risk during the risk identification and assessment process.
- However, in terms of scalability, we consider that assessing the design and implementation of controls is not always necessary to understand each component of the entity's system of internal control system, particularly for entities in a simple and low-risk environment (i.e. small or less complex entities) for which a full substantive audit approach will be adopted.
- We consider that the requirement that consists in identifying controls relevant to the audit, evaluating their design and determining whether they have been implemented (paragraph 39e) is of limited value for smaller and less complex entities, since in such context, a fully substantive audit approach will be chosen. We therefore find the requirements of paragraph 39 (e) not necessary since in a smaller/not complex entity environment the auditor will not necessarily need to rely on understanding the controls to identify potential risks. Furthermore, we believe that clarifications are critical and necessary as to:
 - What controls "relevant to the audit" are;
 - Whether "understanding of" is intended to be clearly differentiated from "evaluating the design and implementation of", including the expected form and granularity of documentation.
- With regards to paragraph 39 in the ED, we believe that the inclusion of bullet (e) is confusing and duplicative as it seems that bullets (a) to (d) already cover all possible situations. We suggest this bullet be removed.

14. Hong Kong Institute of CPAs

- In general, the proposed requirements and application material have been appropriately enhanced and clarified in relation to the auditor's understanding of each component of the entity's system of internal control and identification of controls relevant to the audit. We welcome the scalability consideration, for instance, paragraph A90 highlights that the nature, timing and extent of procedures to understand the entity's system of internal control will vary from entity to entity and may depend on factors such as size and complexity of the entity.
- A key consideration will be how much understanding (thus expected level of documentation) is needed for auditors to illustrate their 'thought process' in risk identification and assessment, given

that the extent of understanding of the entity's system of internal control varies depending on factors in A90.

- We note in paragraph 36 that the auditor is required evaluate the design of the information system controls relevant to financial reporting, by understanding how the matters in paragraph 35(a)-(d) are addressed by the entity, and implemented. In the application material in paragraph A154, the auditor is to consider whether such controls would meet their financial reporting objectives, if implemented as designed and operating effectively. It would be helpful for the IAASB to clarify whether the auditor is expected to test operating effectiveness.

15. IDW

- Based on our consideration of paragraph 39 of the draft, we believe that the requirements related to the identification of controls relevant to the audit have been largely clarified. We agree with many of the enhancements made, but strongly disagree with the requirement in paragraph 39 (b).
- We recognize that paragraph 39(b) reflects an existing requirement in extant ISA 315. However, this requirement has caused considerable controversy among auditors of financial statements of smaller and less complex entities, who believe they are being asked to test the design of controls when this is not necessary. As noted above, we acknowledge that testing the design of controls can be an important source of information to enable the identification of both risks of material misstatement at the financial statement level and inherent risks (which are defined as being at the assertion level), and to enable the assessment of those risks and of control risks (also defined at the assertion level). However, there are many circumstances – particularly in smaller and less complex entities – in which, based on previous experience with the entity, the auditor knows in advance that particular inherent risks (which are defined at the assertion level) will be close to the upper end of the spectrum of inherent risk and are therefore significant risks as defined. Furthermore, based on previous experience with the entity, the auditor will also know in advance that he or she will not be relying on the operating effectiveness of controls in relation to those inherent risks and that the auditor expects to obtain sufficient appropriate audit evidence in relation to those risks through substantive procedures alone. The auditor may also expect to be able to design appropriate substantive procedures to address those inherent risks because the risks did not arise due to the inherent risk factor “complexity”. Essentially, this means that the auditor expects the financial statements to be materially misstated in relation to the noted inherent risk and that the auditor expects to need to communicate the material misstatement determined by the auditor to management and to request management to correct that misstatement pursuant to ISA 450.8.
- In these circumstances, testing the design of controls related to those significant risks when those risks are not complex would not lead to more information for the identification or assessment of inherent or control risks, nor be helpful in the design of substantive audit procedures to address the inherent risks. Hence, performing tests of design of controls are superfluous because there is no added benefit to performing them. Consequently, we believe that paragraph 39 (b) should only require controls to be considered relevant when inherent risks are considered significant due to their being treated as a significant risk in accordance with the requirements of other ISAs or due to the “complexity” inherent risk factor.

16. Japanese Institute of Certified Public Accountants

Indirect controls relevant to the audit

- Paragraph A166 prescribes that “controls relevant to the audit are primarily direct controls and are primarily controls in the control activities component.” Additionally, paragraph A104 explains that “controls relevant to the audit are likely to include mainly controls in the control activities component,” but “controls relevant to the audit may also include controls in other components of the system of internal control.” Moreover, paragraph A125 gives an example of direct controls in the entity’s process to monitor the system of internal control: “monitoring activities, such as management or supervisory reviews, may be precise enough to address risks of material misstatement at the assertion level (i.e., direct controls).” Furthermore, paragraph A195 says that “often, only multiple controls, together with other components of the system of internal control, will be sufficient to address a risk of material misstatement,” which suggests that all these controls may be identified as “control relevant to the audit” that require the D&I procedures.
- With regard to these paragraphs, we believe a better clarification of the relationship between the direct /indirect controls and the controls relevant to the audit would enhance the understandability as it is not clearly described whether:
 - Controls in the control environment, the entity’s risk assessment process and the entity’s process to monitor the system of internal control are classified as direct controls when such controls are identified as controls relevant to the audit. In other words, regardless of the components of internal control, only those controls that are precise enough to address risks of material misstatement at the assertion level (i.e., direct controls) are identified as controls relevant to the audit, and the auditor evaluates the design of those direct controls and determines the implementation.

OR

- Classification of direct and indirect controls is introduced to assist identification of “control relevant to the audit” that address risks of material misstatements at the assertion level. Although controls relevant to the audit are primary direct controls, some indirect controls can be controls relevant to the audit.
- Additionally, we propose that the IAASB should include examples of indirect controls which are identified as controls relevant to the audit other than general IT controls, which are identified in accordance with paragraph 41(b), in order to enhance understandability. Paragraph A197 describes that “Controls that support other controls are indirect controls. The more indirect the relationship, the less effective that control may be in preventing, or detecting and correcting, misstatements related to the risk of material misstatement.” This description may cause some readers to interpret that no indirect controls are identified as controls relevant to the audit, and that the auditor is not required to evaluate the design and implementation of these controls. Therefore, we propose that ED-315 should clearly state that there can be circumstances where indirect controls, which support the effective functioning of other direct controls, can be identified as controls relevant to the audit. Such clarification would enhance the consistency with ISA 330, which describes that, for example, when the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, additional audit evidence may be obtained by testing the indirect controls.

Controls relevant to the audit

- Paragraph 39 lists the criteria of controls relevant to the audit. However, it appears to be unclear as to the linkage between the assessment of inherent risk and the identification of controls relevant to the audit due to the lack of description of the relationship between the controls relevant to the audit and the significant classes of transactions, account balances and disclosures. Paragraph 35 requires the auditor to obtain an understanding of the information system relating to significant classes of transactions, account balances and disclosures. It appears that the description of paragraph 39 does not balance out this paragraph. This may lead some readers to interpret that the auditor is required to obtain an understanding of controls related to not-significant classes of transactions, account balances and disclosures.
- Significant risks, risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and significant classes of transactions, account balances or disclosures are all determined based on the assessment of inherent risk. Additionally, controls relevant to the audit are identified based on the determination of significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence. However, in the requirement section, the term “significant classes of transactions, account balances and disclosures” mentioned in paragraph 35 may give an impression to some readers that the term is introduced without appropriate explanation as the determination of significant classes of transactions, account balances and disclosures is described in the following paragraph 46 which states that “The auditor shall determine significant classes of transactions, account balances and disclosures, and their relevant assertions, based on the identified risks of material misstatement.” Additionally, paragraph 35 is located before paragraphs 49 and 51 on the determination of significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence. The purposes of ED-315 include clarifying when controls are considered to be relevant to the audit, and determining the risk of material misstatement more consistently and effectively. To achieve these purposes, we believe that ED-315 should describe the risk assessment process in such a way that the identification of controls relevant to the audit generally comes after identification of significant classes of transactions, account balances or disclosures, and determination of significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, which are all based on the assessment of inherent risk.
- Paragraph 49 in the explanatory memorandum in ED-315 describes that “the IAASB acknowledges that the order in which the requirements related to the identification of the risks of material misstatement are to be applied should not be prescribed.” We understand that the IAASB’s intent is to ensure flexibility in practice. However, we believe that ED-315 should be based on the conceptual flow of the auditor’s risk assessment process. Flexibility can be explained in the application materials.
- Therefore, we suggest that the requirements for the assessment of inherent risk, and also the determination of significant classes of transactions, account balances or disclosures, significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence should be moved before the requirements relating to obtaining an understanding of controls at the assertion level (i.e., before paragraph 35) or paragraph 25, which requires obtaining an understanding of the entity’s system of internal control.

17. Malaysian Institute of Accountants

The inclusion of a list of controls that are relevant to the audit in paragraphs 39 to 41 are helpful. It is clarified that controls relevant to the audit are primarily direct controls and are primarily controls in the control activities component. Further, we also support the inclusion in paragraph A166 that there may be direct controls that exist in the control environment, the entity's risk assessment process or the entity's process to monitor internal control components.

18. Nederlandse Beroepsorganisatie van Accountants

- The definition of controls seems to be narrowed. In the current ISA the process is mentioned to achieve the entity's objectives. In the ED it concerns the policies and procedures to achieve the control objectives. In our opinion, the new definition is too narrow although policies and procedures are meant as a broad term. Controls are more than just policies and procedures. We recommend to reconsider this.
- The fallacy of the assumption that the system of internal control is expected to operate effectively before the actual testing thereof still exists in paragraph 50. This is a self-fulfilling prophecy. Before the auditor can assess the control risk at less than maximum, he should first test the operating effectiveness of the controls and not the other way around. If the auditor assumes that the controls are operating effectively, he will not perform many audit procedures to test this and as a result he will not find control deficiencies. Then he relies inappropriately on the operating effectiveness of the controls. The phrase 'control risk at lower than maximum' might suggest that limited testing of controls might be appropriate whilst extensive testing of controls is required in this case. This is also not clear in the conforming amendments in ISA 330. Risk assessment and risk response are mixed up. We recommend to change this and make clear that only after appropriate testing the control risk can be assessed at less than maximum. This should be mentioned briefly in ISA 315 and elaborated in detail in ISA 330, which should be revised more than just the current conforming amendments.
- In the ED mainly the design and implementation of controls is mentioned (e.g. paragraph 39e). More attention should be given to (the testing of) the operating effectiveness of the controls.
- It is not clear what should be done in the case when substantive procedures alone are not sufficient and controls are not operating effectively. We recommend to provide guidance in this area.
- The standard explains that in small and medium sized entities internal control is more informal. The standard does not provide guidance whether and how these more informal controls can be tested. We recommend the IAASB to provide guidance on the possibilities to test controls within SMEs.

19. National Board of Accountants (Tanzania)

We recommend to put examples of relevant controls to the audit for smaller and less complex size of operations.

20. NZ Auditing and Assurance Standards Board

- In response to the first part of the question the answer is yes. Paragraph 39 of ED-315 provides a clear and easy to understand list of controls that are relevant to the audit and clarifies what is expected from auditors in relation to the relevant controls.

- The NZAuASB's response to the second part of the question is a tentative yes due to some concerns in relation to the required procedures to understand the entity's use of IT in the information system. The NZAuASB's concerns about this are further discussed in the response to question 5(c) below.

Accounting Firms

21. Altaf Noor Ali Chartered Accountants

There are two separate questions:

- Yes, the auditor's identification of controls relevant to the audit have been appropriately enhanced but do not appear to be appropriately clarified.
- No, the guidance for audits of smaller and less complex entities is not clear. Most small and medium size entities do not have adequate internal controls. They are short in every component of the internal control.

22. BDO International

Reference 1:

Design and implementation of controls when control risk is set at maximum

- We have significant concerns regarding the requirement to assess design and implementation (D&I) of controls relevant to the audit and information system controls relevant to financial reporting in situations where the auditor does not plan to take reliance from those controls (i.e. the auditor plans to set control risk at maximum and perform a fully substantive audit). We do not object to the auditor obtaining an understanding of these aforementioned controls, but we do not see the value in assessing the D&I of those controls when the auditor is planning a fully substantive audit. ED-315 does recognize that control risk should be set at maximum when the auditor does not plan to test operating effectiveness of controls; we think ED-315 should go further and state that it is not necessary to assess D&I of controls relevant to the audit or information system controls relevant to financial reporting when control risk is set at maximum.
- We acknowledge that it is necessary to obtain an understanding of these controls for the purpose of identifying and assessing the potential risks of material misstatement at the financial statement level and the assertion level (paragraphs A89, A102). However, we do not see any rationale in ED-315 for requiring an assessment of the D&I of those controls.
- For smaller non-complex entities, we believe that obtaining an understanding of those controls is sufficient for identifying risks and often for determining that testing operating effectiveness of controls is not a viable testing strategy option. On these engagements, practitioners believe there is minimal value to this D&I work effort or documentation; it has no impact on the audit strategy and provides no additional value to the entity nor to the public interest. In our opinion, assessing D&I in these situations would not improve quality on these smaller non-complex audits.

Reference 2:

As stated in our overall comments on page 1 above, we have significant concerns regarding the requirement to assess design and implementation of controls relevant to the audit and information system controls relevant to financial reporting in situations where the auditor does not plan to take assurance from

testing those controls (i.e. the auditor sets control risk at maximum and plans to perform a fully substantive audit). See page 1 for details of our concerns.

Reference 3:

- Compared to the current standard, the ED is now quite clear that the auditor evaluates design and implementation of controls relevant to the audit (paragraph 26). Such controls relevant to the audit can arise in any of the five components of internal control (i.e. not just control activities).
- However, the application guidance in paragraph A166 states that controls relevant to the audit are primarily direct controls in the control activities component because such controls are typically over the entity's information system and address risks of material misstatement at the assertion level. It then continues on to say that there may be direct controls in the other components. Our interpretation of these words in the standard is that while there may be controls relevant to the audit in the other components, most controls relevant to the audit will still be in the control activities component.
- The definition of controls relevant to the audit in paragraph 39(a) - (d) is fairly clear, particularly given the explanations provided in the related application guidance paragraphs regarding controls over significant risks and journal entries. However, it is still difficult to understand how far the auditor needs to go to identify other controls relevant to the audit as required by paragraph 39(e) - those that "in the auditor's professional judgment, are appropriate to evaluate their design and determine whether they have been implemented to enable the auditor to:
 - Identify and assess the risks of material misstatement at the assertion level; or
 - Design further audit procedures responsive to assessed risks".
- The related application guidance in paragraph A179 is helpful because it provides two specific situations (revised information systems and high (but not significant) risks). But a statement (in paragraph 39 or in the related application guidance) that paragraph 39(e) allows other controls to be identified as relevant to the audit but does not require an active search by the auditor would be helpful.
- There didn't seem to be much guidance for smaller non-complex entities in this section on controls relevant to the audit other than in paragraph A167 which states that smaller and less complex entities may not have any controls relevant to the audit other than over journal entries. However the guidance in paragraph A167 is useful.
- In addition, ED-315 highlights that a control that is relevant to the audit may be 'implied through actions and decisions' but may not be formally documented. Guidance on performing and documenting the design and implementation of such controls, as well as the operating effectiveness of such controls, would be useful.

24. Crowe International

- The requirements related to "controls relevant to the audit" are clearly presented.
- There is an area where more application guidance is needed to help with applying the requirements of the standard to audits of smaller and less complex entities. "Controls relevant to the audit" are becoming more important on these engagements because of advances in technology and expectations driven by developments such as tax digitalization. Whilst IAASB's forthcoming project on the audit of SMEs might help in this year, IAASB ought to expand this section to more fully show that there are "controls relevant" on smaller and less complex audits.

25. Deloitte

While the identification of relevant controls to the audit has been enhanced within ED-315, DTTL believes that the proposed standard should provide further clarification on two areas.

- First, further guidance should be provided on paragraph 39(e)(i) to assist auditors in identifying scenarios in which controls would be required to be identified in order to “identify and assess the risks of material misstatement at the assertion level.” DTTL believes adding additional examples to A179 to address 39(e)(i) is essential in helping auditors understand when such controls are relevant to the audit.
- In addition, “indirect controls” are discussed within the application guidance; however, the proposed standard does not clearly address when indirect controls should be identified as controls relevant to the audit. The IAASB should expand the proposed standard, including consideration of application material, to address when indirect controls should be identified as relevant to the audit.

26. EY Global Limited

Introductory comments:

We support the clarifications to ‘controls relevant to the audit’ as well as the introduction of the concept of direct and indirect controls, which we find very useful in clarifying the nature of controls expected to be relevant to the audit. We also support the changes to the guidance related to the components of the entity’s system of internal control, especially the change in terminology for ‘the entity’s process to monitor the system of internal control’, as we believe this is a better description of what this component entails.

Question 5(b):

Yes, except that we find paragraph A233 confusing. ED-ISA 315 (paragraph 50) requires that control risk be assessed at ‘maximum’ or ‘less than maximum’, which implies a binary choice, and this is supported by the example in paragraph A233, as well as other parts of ED-ISA 315 (e.g., Paragraph 6). However, the application material in the remainder of paragraph A233 implies an assessment using qualitative categories that include ‘moderate’ and ‘minimum’. It is not clear how these categories would be applied, nor what effect that would have on the audit procedures. Does ‘moderate’ imply an expectation of ‘partial’ operating effectiveness, requiring a suite of ‘moderate’ controls to address a risk of material misstatement? Therefore, we recommend deleting the first two sentences of paragraph A233, and combining the example in paragraph A233 into paragraph A232.

27. Grant Thornton International

Reference 1:

As elaborated further in our detailed response, there are, however, several areas where we have concerns over the proposals in ED 315:

- The lack of consideration of how the evaluation of the design of controls and determination of their implementation, absent testing the effectiveness of the controls, impacts the auditor’s assessment of the risk of material misstatement, as control risk will be assessed at maximum and inherent risk is assessed without regard to controls. This will have a consequential impact on the procedures that are performed by the auditor, particularly when using audit sampling in response to the assessed risk of material misstatement.

Reference 2:

We agree that the requirements and associated application material related to the auditor's identification of the controls relevant to the audit represents an enhancement on extant ISA 315 (Revised). However, we note the following:

- Consistent with our response to Question 2, the interaction of paragraph 35 with paragraph 39 of ED 315 results in a lack of clarity regarding controls relevant to the audit; the requirement to understand the information system relevant to financial reporting would appear to negate the requirement to understand only those controls relevant to the audit.
- Paragraph 39(e) of ED 315 requires the auditor to identify controls relevant to the audit that have not been identified by complying with the first four parts of this requirement. This requirement is awkward in its construction and is a "catch-all" requirement that will require significant professional judgment in its application. In comparison to other parts of this requirement, there is little application material to assist the auditor in how to make the identification. Guidance on how other controls relevant to the audit are determined, including the factors the auditor considers in making the determination, along with practical examples in this area would be helpful to prevent inconsistent application in practice.
- Paragraph 39 of ED 315 also states that "not all controls relevant to financial reporting are relevant to the audit." Examples of such controls would also be helpful.

28. KPMG IFRG Limited

This is a complex area, and auditors need a clear framework to underpin their use of professional judgement. We therefore highlight the following areas where we believe there is a lack of clarity:

- We are unclear as to the intended scope of the requirement at paragraph 39(e). As drafted, with reference to professional judgement, it may be intended to be a "catch all" to capture, in particular, "indirect" controls, such as when these may provide relevant information to identify fraud risk factors and identify assertion level fraud risks, and provide information related to matters such as management competence, which may help the auditor to assess inherent risks at the assertion level. However, the application material at A179 appears to refer to controls that are "direct" in nature e.g. changes in the information system.
- Additionally, we believe this requirement appears to contain circular logic since it requires auditors to evaluate the design and implementation of controls relevant to the audit, as determined appropriate by the auditor, in order to identify and assess risks of material misstatement at the assertion level or design further audit procedures responsive to assessed risks. However, since direct controls would be considered to be relevant to the audit *when* they address risks of material misstatement (at the assertion level), it would be challenging to comply with this requirement, without evaluating most/ all direct controls, in order to make this determination. Furthermore, as a result of the circularity, it would be challenging for an auditor to determine when sufficient assessment has been performed. Therefore, we suggest that the IAASB clarify whether the requirement at paragraph 39(e) is intended to refer only to indirect controls, and, if so, to relocate this requirement accordingly, or to remove it completely.
- In light of the overarching objective to obtain sufficient appropriate audit evidence as the basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels, we recommend that the IAASB provide greater clarity as to how evaluation of the design and implementation of direct controls (control relevant to the audit) assists an auditor in

identifying and assessing risks of material misstatement at the assertion level. We recognise that the guidance, in particular at A200, sets out that this contributes to the auditor's understanding of the entity's system of internal control, however, we would welcome further clarity, and illustrative examples, in respect of both direct and indirect controls, as well as in respect of when the evaluation of the design and implementation of controls identifies control deficiencies. Since inherent risk is assessed without consideration of "direct" controls (controls relevant to the audit), and furthermore, if the auditor does not plan to test the operating effectiveness of such controls, and therefore control risk is established at maximum, the evaluation of design and implementation of direct controls does not impact on the control risk assessment. We understand the IAASB's intention to avoid situations in which auditors may place inadvertent reliance on controls and therefore this has implications for the further audit procedures that would not otherwise be performed. However, it is unclear how an auditor is to determine when it is appropriate to evaluate the design and implementation of direct controls for this purpose.

- Also, the related application material at A179 states that the evaluation of the design and implementation of these controls contributes to the audit evidence related to risks of material misstatement that are assessed as higher, but not significant on the spectrum of inherent risk. We note further that A179 states that similar to controls over significant risks, the auditor's evaluation of the design of these controls and determination of whether they have been implemented contributes to the audit evidence related to that higher risk. It is unclear how performance of procedures to evaluate the design and implementation of these controls would assist an auditor in identifying and assessing risks of material misstatement at the assertion level. It would be helpful if the IAASB were to clarify whether their intention is to suggest that this may provide audit evidence for inherent risk assessment, and if this is the case, to provide an illustrative example, or whether the intention is to suggest that this would help an auditor to make a preliminary assessment of control risk when considering whether it would be appropriate to test operating effectiveness.
- In connection with our comments earlier regarding what constitutes a "relevant" control, we believe that the current definition may result in inference by auditors that this equates to whenever a risk of material misstatement has been identified. We suggest that the IAASB provide clarification, and if this is the intended meaning, we recommend the IAASB explore further as to whether this is appropriate, given the expected impact on the audit.
- We also highlight that the requirement at paragraph 39(c) in relation to controls over journal entries, including non-standard journal entries is unclear. In order to improve consistency of application it would be helpful for the IAASB to provide guidance on the application of design and implementation for journal entries that are almost always/ often dependent on controls for the underlying data and transactions including how this requirement may relate to automated controls. We recognize that the extant standard contains an equivalent requirement, however, we recommend that the IAASB consider their intention behind the extant requirement and explore whether it is appropriate to retain this in the ED, given the significant evolution in the use of IT by businesses in recent years, with the result that many journal entries are processed automatically, and are reliant on other controls for completeness and accuracy.

Appropriate Criteria for the Evaluation of Controls

- In addition to the above, the ED requires the auditor to evaluate the design and implementation of controls at various points, however, the application material does not provide guidance or criteria as to how this evaluation is to be performed, other than reference to consideration as to whether the

control is determined to meet the control objective established by management. We suggest the IAASB consider inclusion of similar material to the description of attributes of suitable criteria for assurance engagements, set out in ISAE 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*, such as whether criteria are relevant, complete, reliable, neutral and understandable, and whether their development has involved appropriate due process. Although we recognise that the ED is not intended to address an audit of internal control over financial reporting, we suggest that the IAASB consider guidance in the COSO Framework, in particular, the concept of “present and functioning” (i.e. when applied to components of internal control, and related principles, “present” refers to the determination that components and relevant principles exist in the design and implementation of the system of internal control to achieve specified objectives, and “functioning” refers to the determination that components and relevant principles continue to exist in the conduct of the system of internal control to achieve specified objectives), as representing suitable criteria for making such an evaluation.

- The COSO Framework also addresses critical considerations, in determining the attributes of a control that is suitably designed, including who at the entity is performing the control, whether they possess sufficient competence, what the specific objective of the control is, how the control is to be executed and also refers to safeguards such as segregation of duties. In this regard, we highlight our earlier comments regarding differences from the COSO Framework, which is a clearly understood framework with a broad global usage, and suggest that the IAASB give further consideration to alignment, especially given that in other respects the IAASB appears to have sought to increase alignment.

29. MNP LLP (Canada)

The list of controls included in paragraph 39 provide a clearer picture of which controls are relevant to the audit.

30. PwC International

- We welcome the intent of paragraph 39. Explicitly describing those controls that the auditor must always consider will eliminate confusion that exists in applying extant ISA 315. However, we believe the standard can give direction on those controls the auditor must always understand without specifically needing to define a term for such controls. This is reflected in our suggested alternative requirements described above.
- With respect to the requirements as proposed in the ED, the understanding and interpretation of the flow and interaction of paragraphs 26, 36, 38, 39 and 40-42 is critical to success. In that regard we have a number of observations and concerns.
- We are unclear as to the purpose of paragraph 26 and suggest further consideration be given as to whether it is necessary or can be deleted.
- We do not support proposed paragraph 36. Paragraph 39 identifies the controls for which the auditor must obtain an understanding. However, the intent of paragraph 36 appears to be that all controls within the information system that fall within the scope of the requirement (see related comment below) must be identified and an evaluation of their design and whether they have been implemented performed. It will aid understanding if all controls the auditor needs to understand and evaluate are addressed in one clear requirement.

- However, we disagree that all information system controls need to be understood and evaluated. Evaluating the design and implementation primarily serves to support a controls based approach and, in our view, this requirement imposes a level of work effort on audits that may not plan to place reliance on controls, in particular for smaller and less complex entities, that we do not believe is necessary.
- The wording of paragraph 38 also could cause confusion. Extant ISA 315 equated obtaining an understanding of the control activities “component” to understanding and identifying controls relevant to the audit. Referring to identifying the controls relevant to the audit “in” the control activities component is a confusing concept. As the application material describes, such controls are typically controls over the entity’s information system, but also may be controls in other components.
- While we believe the defined term is unnecessary, we welcome the clarity brought by describing those direct controls which the auditor is always required to treat as “relevant” (paragraph 39(a)-(d)). However, paragraph 39(e) is, in our view, problematic. Leaving an open-ended judgement as to any other control for which it is “appropriate” to evaluate its design, and determine whether it has been implemented, undermines the clarity provided by other elements of the requirement. This retains the ambiguity of this concept that exists today. If none of items (a)-(d) are triggered, and specifically, under (d), when the auditor does not intend to rely on controls, then we see no circumstances when (e) becomes applicable. We believe paragraph A179 is further application material that is relevant to judgements the auditor needs to make relevant to (d). Alternatively, the requirement needs to go further to define the criteria or circumstances when it would be “appropriate” – if this cannot be done, then we question whether this belongs as a requirement.
- Furthermore, coupling the judgmental requirement of (e) with the overarching requirement to obtain “sufficient appropriate audit evidence” from the auditor’s risk assessment procedures, as a whole, results in a highly subjective and unclear threshold as to how much work is expected of the auditor.
- We seek to address each of the points described above in our initial outline of suggested redrafted requirements in Appendix 2. In our suggestions and in our comments in Appendix 3, we note that we do not believe it is necessary that all controls over journal entries be mandated as relevant, as this should be based on the assessed risks.

31. RSM International

- The listing of controls relevant to the audit in the application paragraphs is helpful.
- More guidance could be provided for understanding the distinction between direct and indirect controls within paragraph A166.
- We consider that the application material should address how such controls should be identified and the factors influencing the auditor’s judgement in determining whether it is appropriate to evaluate their design and implementation.
- As a scalability issue, it would help if there were acknowledgement of the fact that in audits of small or less complex entities in which a fully substantive approach is taken, there are likely to be fewer controls on which to rely.

Public Sector

32. Office of the Auditor-General of Alberta

- We agree. However, we are concerned about the concept of significant risk and suggest it be removed.
- We are unsure how paragraph 39 (e) would be applied in practice. It seems to suggest that a control is relevant if the auditor needs to assess control risk with respect to that control, which is then every control relevant to financial reporting, which makes the second last sentence in paragraph 39 “Not all controls that are relevant to financial reporting are relevant to the audit” contradictory. Or 39 (e) may imply that the standard recognizes that some controls may actually introduce additional risk i.e. raise the level of risk above inherent risk? Paragraph A179 does not help and makes it more confusing by a reference to ISA 330. Unless clear examples of paragraph 39 (e) can be provided, we suggest it be removed.

33. Office of the Auditor-General of Canada

- Yes, the requirements related to the auditor’s understanding of each component of the entity’s system of internal control are clear with the exception of paragraph 36 which states the auditor “shall evaluate the design of the information system controls relevant to financial reporting”.
- This requirements appears to introduce a need to evaluate control design as part of gaining an understanding of the information system controls. Design and implementation is evaluated for controls identified as relevant to the audit in accordance with paragraph 42. In our view, the reference to design evaluation in paragraph 36 is not clear given it is the same terminology (design evaluation) expressed in paragraph 42. We would suggest further clarifying the requirements of paragraph 36.
- Yes, the requirements related to the auditor’s identification of controls relevant to the audit have been appropriately enhanced and clarified, with the exception noted in our response to question 5a) above. It is clear how controls relevant to the audit are identified, regardless of the type of entity subject to audit.

35. US Government Accountability Office

We suggest that the IAASB consider further clarifying the requirements related to the auditor identifying controls that are relevant to the audit. We have some concerns that paragraph 39(e) allows a significant amount of flexibility in determining which controls the auditor is required to evaluate.

36. Swedish National Audit Office

We are struggling with understanding the relations between paragraph 36, 38 and 39. All three discuss relevant controls and we find it difficult to see the distinction, especially between paragraph 36 and 38.

Member Bodies and Other Professional Organizations

38. ACCA-CAANZ

The trigger for determining controls relevant to the audit is the ‘reasonable possibility’/‘more than remote’ test. As noted in our response to Question 1(b), we do not support defining these two terms as equivalent.

39. Accountancy Europe

Reference 1:

- We agree that auditor's *understanding* of each component of the entity's system of internal control is a prerequisite of assessing control risk during the risk identification and assessment process.
- However, from a scalability standpoint, we do not consider that assessing the design and implementation of controls is always necessary to understand each component of the entity's internal control system, particularly for entities in a simple and low-risk environment (small **or** less complex entities) for which a full substantive audit approach will be adopted.
- Requiring such work at best prevents the auditor's resources being applied to more valuable aspects of the audit and at worse results in significant audit documentation which is of little value and could obfuscate the real audit issues. While an understanding of at least the overarching internal control systems has to feed into the risk assessment process, a detailed documentation or testing may not be appropriate (i.e. where the auditor understands enough to know that the controls are not sufficient/satisfactory for further relevance in the audit). Auditors should not be required to perform unnecessary work that would make the audit ineffective in terms of cost benefits in the smaller entities market.

Reference 2:

- Following on the point above, after the assessment of the control system for an entity that has a simple and low-risk environment, auditors might conclude that there are relatively few controls relevant to the audit and might adopt a fully substantive approach. Therefore, we consider that the requirement to identify controls relevant to the audit, evaluate their design and determine whether they have been implemented (*paragraph 39(e)*), is of limited value in the context of auditing entities in a simple and low-risk environment, for which a fully substantive audit approach is the chosen audit strategy. We are particularly concerned with the requirements in *paragraph 39(e)* which is open ended. We find the requirements in this paragraph not conclusive and duplicative, since in a smaller/not complex entity environment the auditor will not necessarily need to rely on understanding the controls established by management to identify potential risks.
- Despite the fact that we find *paragraph 31(a)* useful to determine the work effort required in a simple and low-risk environment, the paragraph does not address all aspects of scaling down the requirements of the standard.
- Similar considerations could be made in other areas of the standard where scalability would be necessary (ex. aspects raised in points a) and c) of this question), to allow the use of professional judgement – the cornerstone in the effective application of principle-based standards.
- As an overarching comment to the two proposals above, the IAASB should also make it clear in its project to revise ISA 500 that, where the auditor determines that a fully substantive approach is sufficient for entities in a simple and low-risk environment, limited, if any work should be required to assess design and implementation of controls.

40. AICPA

Reference 1:

Finally, we believe that the PCAOB has useful guidance in the area of evaluating the design effectiveness of internal control. We note that this is an area that is often misunderstood and results in inconsistent

application in practice. Therefore, we recommend that the IAASB consider including that guidance in finalizing the standard. Specifically, paragraphs 19 and 20 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatements*, provide guidance on testing the design effectiveness of controls, including guidance for audits of smaller, less complex companies.

Reference 2:

- Paragraph 36 — This paragraph states, in part, “The auditor shall evaluate the design of the information system controls relevant to financial reporting”...We are concerned this requirement may be interpreted as requiring the auditor to evaluate **all** controls over financial reporting that the entity might have in place. We recommend the standard clarify this evaluation is not expected to include aspects of the information system that do not have a reasonable possibility of including controls **relevant to the audit**.
- We also recommend the standard clarify how the requirement in paragraph 36 interacts with paragraph 39, which deals with controls within the control activities component.
- We understand that the intent of the IAASB is to recognize that understanding the financial reporting process used to prepare the entity's financial statements (as described in paragraph 35) is always relevant to the audit. However, we are concerned that the wording of paragraph 36 may be interpreted as requiring evaluation of the information system and communication component taken as a whole (which would not be an appropriate requirement because the auditor would not necessarily have a basis to do so, that is, there are no criteria in the standard to make such an overall evaluation, and this is not the objective of the risk assessment process). The evaluation related to an internal control component should be performed by the auditor at the control level, as described in paragraph 42(a), for those controls relevant to the audit as described in paragraph 39.
- To make this approach clearer, we suggest that paragraph 36 be replaced by the following, to be consistent with paragraphs 27 and 38]:

Based on the understanding of the information system and communication component obtained by performing the procedures in paragraph 35, the auditor shall identify the controls relevant to the audit, as described in paragraph 39 that are included in this component.

- We also then recommend paragraph 42 be amended to highlight controls relevant to the audit identified within the information system and communication component as follows:

42. For each control identified as relevant to the audit in accordance with paragraphs **36**, 39 and 41, the auditor shall...

- Paragraph 50 — This paragraph (and also in application material), the IAASB introduces the term “maximum.” We believe this is problematic because it seems to convey a notion of a precise point in the spectrum of control risk. We believe variations of control risk exist even within the categories of low, medium, or high. Instead of the term “maximum,” we recommend that the IAASB use a term such as “high,” recognizing that firms may use other schemes in the assessment of control risk. This is important in terms of emphasizing the notion that an auditor cannot assess control risk below high without testing operating effectiveness. Assigning of value of “high” in the assessment of control risk would also help the auditor understand that evaluating whether controls are effectively designed and implemented may influence the nature, timing and extent of further audit procedures.
- Paragraph A142 — This paragraph describes potential sources of information outside the core accounting system, in support of paragraph 35(a)'s point that such information may relate to

significant classes of transactions, account balances and disclosures. We recommend paragraph A142 also caution the auditor that such information may not have the same internal control environment and structure that information produced by the core accounting system may have.

- Paragraph A168 — This paragraph, which is application material for paragraph 39(a), relates to controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence. However, it appears to simply reiterate the requirement and connect it to the requirement to test the operating effectiveness of controls in ISA 330. To help auditors understand when this situation may arise, we believe it would be helpful if paragraph A168 provided one or two examples of when that condition may be present.
- Paragraph A194 — This paragraph provides guidance as to how the auditor evaluates the design of controls, specifically, whether they are capable of effectively preventing, or detecting and correcting, material misstatements. We recommend this guidance include consideration of the extent to which the controls, if properly operating, would prevent, or detect and correct, material misstatements, either on their own or in combination with other identified controls. Determining that a control is capable of preventing, or detecting and correcting, material misstatements does not provide the auditor with sufficient information to assess control risk and design further audit procedures.
- We note that paragraphs 72–73A of PCAOB Auditing Standards section AS 2110, *Identifying and Assessing Risks of Material Misstatements*, specifically highlight the need to evaluate the design effectiveness of controls related to significant risks, including fraud risks, and significant unusual transactions. ED-315 addresses this by including such controls in the definition of controls relevant to the audit in paragraph 39 and by requiring evaluation of the design effectiveness of such controls in paragraph 42(a). Paragraphs A194–A198 of ED-315 contain some of this guidance, but we believe that the application material in ED-315 could be enhanced by inclusion of the wording in the relevant paragraphs in the PCAOB standards.
- Paragraph A199 — We are very supportive of the guidance in this paragraph as well as the guidance in paragraph A200. We believe that these paragraphs are very important in articulating the extent of the requirement to gain an understanding of internal control, and such guidance greatly helps on the issue of scalability. Given the importance of this guidance, we recommend that these paragraphs be more prominently featured in the standard. For example, this guidance could be included in the introductory paragraphs of the standard in perhaps a separate section related to scalability concepts.
- We also recommend the discussion of a “spectrum” of control risk in paragraph A233 be given more prominence in the standard, to help the auditor understand there may be varying levels of reliance on controls depending on the extent of testing of operating effectiveness and the auditor’s judgment regarding the degree of effectiveness of controls in preventing or detecting material misstatements.

41. Center for Audit Quality

The language in paragraph 39 correctly notes that not all controls relevant to financial reporting are relevant to the audit. However, the requirement in paragraph 36 to evaluate the design and implementation of system controls relevant to financial reporting is too broad and should be clarified. The focus in paragraph 36 should be on identifying controls relevant to the audit within the information system component, and evaluating the design and implementation of those controls, following on from the requirement in paragraph 35 to understand the information system. We also find the introduction of the term “information system controls relevant to financial reporting” to be confusing when compared to paragraph A157.

42. Chartered Institute of Public Finance & Accountancy

Overarching response provided to give context to 'controls relevant to the audit' comment:

Some of the drafting in ED-315 thus represents a real improvement in explaining how auditors understand audited entity processes and systems, make preliminary assessments of risks, and follow up with possibly repeated cycles of more focused consideration of systems, and consequent reconsideration and assessment of risk.

However, much of the benefit of the improved framing and the new material is lost because its placement in the proposed revised standard reduces understandability. The main body of the standard is overlong and the level of detail is too great. The approach to control risk also appears to be rather mechanistic and framed in language which is more grounded in specific methodology than is appropriate for a standards level discussion. Some parts of the requirements in ED-315 read like a checklist which is not adequately supported by explanation.

In our view the main body of the standard needs to be considerably more concise, providing an understandable basis for the consideration of risk, supported by more detailed application guidance which is appropriately placed.

For the reasons set out above, we consider that IAASB should revisit the placement of the proposals in ED-315, and take the time needed to make the drafting of ISA 315 as clear as possible.

Comment on controls relevant to the audit:

Notwithstanding our comments on placement, the proposed revisions include enhanced and clarified material.

43. CPA Australia

- Yes, paragraph 39 clarifies controls relevant to the audit. However, we suggest that sub-paragraph 39(e) is deleted as design and implementation will need to be conducted as part of identifying the relevant controls and is not a reason for them to be relevant. The last part of sub-paragraph 39(e) is effectively a definition of controls relevant to the financial report and controls relevant to the audit, which we suggest is included in a separate paragraph before paragraph 39 and further explained.
- The requirements do not allow for the auditor to obtain an understanding of the control environment and on that basis to decide not to rely on controls and conduct a substantive audit. Instead the auditor is still required to obtain an understanding of all of the other components of internal control regardless of any decision on whether to rely on controls. The option of doing a substantive audit, even that is in relation to specific transactions or balances, should be incorporated into the standard to avoid excessive audit effort and documentation, particularly for audits of small entities.

44. EFAA

Reference 1:

- We question the need for auditors to understand controls where a wholly substantive audit approach is taken. We believe, and our research cited above supports, some high level understanding of controls, and particularly the controls environment, is necessary regardless of the audit approach. We fear, however, that the extent of design and implementation work required under these proposals

and the volume of material on controls and IT generally will only re-enforce the belief in many that ISAs undermine the cost effectiveness and efficiency of smaller audits.

- We note that requirement 21 states that the auditor shall 'evaluate' whether information from audit procedures performed in previous audits remains relevant and reliable. This may imply undue work effort so suggest that 'consider' is more appropriate.
- To facilitate the efficient performance of smaller entity audits we suggest the application material clarify the differences in work required for evaluating the control environment (req. 27 & 28), the entity's risk assessment process (req. 29-31) and controls relevant to the audit (req. 39-42).

Reference 2:

- We believe they have been enhanced and clarified.
- We suggest, however, inclusion of specific acknowledgement that in audits of smaller and less complex entities, in which a fully substantive approach is taken, there are likely to be few controls relevant to the audit that are appropriate to evaluate for their design and implementation.
- We question the need for the auditor to test the design and implementation of controls that address significant risks not subject to complexity when auditors believe that they can respond to the risks of material misstatement through substantive procedures alone. Further, we question whether an auditor in an SME environment always needs to understand the nature of controls relating to managements risk assessment process, or its monitoring of controls (para. 39(e)).
- ED-315 explains that in smaller entities internal control is more in-formal. ED-315, however, does not provide guidance whether and how these more informal controls can be tested. We urge the Board to provide guidance on testing controls within *such entities*.

45. Finnish Association of Authorised Public Accountants

- From the scalability standpoint, we do not consider that assessing the design and implementation of controls is always necessary in order to understand each component of the entity's internal control system, particularly for smaller entities for which a full substantive audit approach will usually be adopted. Requiring such work, at best prevents the auditor's resources being applied to more valuable aspects of the audit and at worst results in significant audit documentation which is of little value and could obfuscate the real audit issues. At least, a detailed documentation or testing should not be required. Auditors should not be required to perform unnecessary work that would make the audit ineffective in terms of cost benefits in small entities.
- Majority of smaller Finnish companies use a 'off-the-shelf' software for accounting. They also generally outsource their accounting. The level of complexity in the revised standard as regards to understanding and evaluating the D&I of the IT environment is too heavy for a vast majority of Finnish companies. Therefore, an exception to the requirements should be incorporated in the standard regarding smaller entities using 'off-the-shelf' software. The Standard should be clearer on the work effort required from auditors in such cases – e.g. a minimum requirement to assess the modifications or updates made to off-the-shelf software package or the modification of standard report functionalities.

46. Fed of Prof Council of Economic Sciences (Argentina)

The requirements to identify the relevant controls and relate them to the direct controls have been adequately improved. The relevant controls mentioned in the consolidated list, supported by the clarifications mentioned in Application and other explanatory Material, in paragraphs A166 to A180, make it possible to clarify the identification thereof.

47. FSR Danske Revisorer (Denmark)

- In our view, it is not always clear when a control is relevant to the audit of small and less complex entities. This is especially the case when a fully substantive based audit approach is adopted.
- The concept of controls relevant to the audit as used in paragraph 39(e) creates, in our view, uncertainty and ambiguity as it leaves an open-ended judgement as to whether it is “appropriate” to evaluate the design and implementation of controls. This coupled with the overarching requirement to obtain “sufficient appropriate audit evidence” from the auditor’s risk assessment procedures, as a whole, results in a highly subjective and unclear threshold as to how much work is expected of the auditor.
- It would be much clearer and more scalable if “controls relevant to the audit” were defined as “controls that are expected to be relied on to provide audit evidence”. We often see in practice that testing of design and implementation of controls related to significant risks have no impact on the assessed risk of material misstatement and the procedures performed to address the significant risk. From a scalability perspective, the requirement to identify controls relevant to the audit should, therefore, be changed to only be required when necessary to understand the specific risk and to respond to that risk.

48. Interamerican accounting association (South America)

Yes, the necessary requirements to identify and evaluate the relevant controls for an audit of financial statements by the auditor have been improved and clarified in a comprehensible manner. The clarity and details of the proposals will positively assist independent auditors, especially small, medium and large less complex entities, to identify those relevant controls for the purposes of issuing an opinion on the financial statements of such entities.

49. Instituto dos Auditores Independentes do Brazil

Further guidance might be helpful on determining the controls relevant to the audit. For audit of smaller and less complex entities, we do not see any changes in the current audit approach, as it is already required to perform the understanding and evaluating of the D&I of controls relevant to the audit.

50. IBR-IRE

We believe that it is feasible to make the requirements themselves scalable. We would like to illustrate this with the following two examples:

- As to the requirements dealing with the information system and communication (paragraphs 35-37 of the ED), the fourth sentence of paragraph A181 could be elevated by modifying paragraph 35(d) as follows:

35. (d) The entity’s IT environment relevant to (a) through (c) above. However, when an entity uses an IT application that is reputable, widely-used and considered reliable, is unable to change its

programming, and maintains hard-copy accounting records, the auditor shall conclude that there are no IT applications relevant to the audit. In such a case, the auditor is likely to be able to obtain audit evidence about the completeness and accuracy of the information produced by the entity through substantive testing without the need to test controls over its production (Ref: Para. A144-A150 and Para. A180-A182).

- As to the requirement relating to controls relevant to the audit (paragraph 39), it would be very helpful to explain in the requirement how it would apply to SMEs, particularly paragraph 39 (e) about evaluating the design of controls relevant to the audit. This could be done by elevating the material in A167 that relates to SMEs to the requirement in paragraph 39. Also, we do not understand why the material in A167 refers to controls over journal entries as this paragraph has to be read more broadly.

51. Institute of Chartered Accountants in England and Wales

- The listing of controls relevant to the audit in the application material is helpful. The question that arises repeatedly in this context is whether there are any situations in which there are no controls relevant to the audit. It has been suggested during recent IAASB webinars on ISA 315 that the answer to this question is no, because controls over journal entries are always relevant to the audit. This answer is presumably based on the assumption that all audited entities use journal entries in preparing the financial statements. We have heard suggestions to the effect that this is not always the case. This is an important issue that should be dealt with in the standard itself and we therefore suggest that IAASB should acknowledge explicitly in paragraph A167 that in some cases, there may be no controls relevant to the audit but that in the overwhelming majority of cases, there will be controls over journal entries. Where such controls exist, they are always relevant. More importantly, the standard should acknowledge that even if there are no controls relevant to the audit, auditors will always need to **understand** the components of internal control in more general terms in order to understand the business and assess risk.
- More guidance is needed to unpack paragraph A166 which is critical to understanding the distinction between direct and indirect controls and refers to important scalability issues. The language used in this paragraph is awkward at best. Clear and understandable examples of specific direct and indirect controls in a simple situation are needed to bring this paragraph to life.
- Paragraph 39 (e) is critical. The subjectivity involved in determining which controls 'are appropriate to evaluate their design and determine whether they have been implemented' (a clumsy construction at best, one that is only just comprehensible in plain English) already leads to inconsistencies in practice. Two audit teams provided with identical facts, this paragraph and the associated guidance in paragraph A179, would unlikely arrive at the same place. Absent further guidance, this is a missed opportunity to encourage greater consistency in the determination of controls relevant to the audit. Of all of the controls relevant to the audit listed in paragraph 39, 39 (e) is the most important, and has the least application material associated with it. Application material should address how such controls should be identified, and the factors influencing the auditor's judgement in determining whether it is appropriate to evaluate their design and implementation. As a scalability issue, it would help greatly if there were specific acknowledgement of the fact that in smaller less complex audits in which a fully substantive approach is taken, there may be few, if any controls falling into this category.
- It would help if there were some reference in the application material to situations in which smaller entities outsource the preparation of financial statements to third parties, including accountants, and

the effect this has on understanding the information and communication component. Our outreach indicates that some practitioners have read the proposals as implicitly requiring service organization reports relating to those third parties in such cases, which we do not believe is or should be the intention.

52. Institute of Chartered Accountants (Ghana)

Yes, the requirements related to the auditor's identification of controls relevant to the audit are appropriately enhanced and clarified and it is clear how controls relevant to the audit are identified. The IAASB in paragraph 39 requires the identification of controls that address risks for which substantive procedures cannot provide sufficient appropriate audit evidence. This is a principles based approach and so this guidance can be applied to all types (simple or complex) of entities. There does not seem to be a discussion on scalability for relevant controls and so the clarity appears to be the same for larger/more complex and smaller/less complex entities.

53. Institute of Chartered Accountants of Pakistan

We also agree that the requirements related to the auditor's identification of controls (contained in paragraphs 39 and A166 and A167) provide clarity on the identification of controls relevant to the audit. However, we consider that the controls relevant to the audit of smaller and less complex entities may be further elaborated with examples for guidance purposes.

54. Institute of Chartered Accountants of Scotland

Following on from the point above, having undertaken the assessment of the control system for a small, low-risk entity, auditors might conclude that there are relatively few controls relevant to the audit and might adopt a fully substantive approach. Therefore, we consider that the requirement to identify controls relevant to the audit, evaluate their design and determine whether they have been implemented, is of limited value in the audits of such entities where a fully substantive audit approach is believed to be the most appropriate audit strategy.

55. Institute of Chartered Accountants (Zimbabwe)

Yes. The flow chart clearly gives guidance on what to do, which includes among others the identification of risks of material misstatements at the financial statements level.

57. Institute of Public Accountants

ISA 315 should give primacy to the understanding the client's system for recording transactions and that the assessment of controls should be a by-product of obtaining such an understanding. As noted in our covering letter, the IPA remains concerned that the proposed changes to ISA 315 do not address the auditors' propensity to defer to a substantive audit approach and only assess control (if at all) at the most superficial level.

58. Institute of Singapore Chartered Accountants

- There may be potential confusion between the controls in the "information system and communication" component (information system controls) and controls in the "control activities" component. As provided in paragraph A160 of ED-315, controls in the "control activities" component include those controls over the flows of information within the information system relating to significant

classes of transactions, account balances and disclosures and the financial reporting process used to prepare the financial statements. This would imply that information system controls and controls in the “control activities” component are inter-related. In fact, we would think that controls in the “control activities” component that are relevant to audit are a sub-set of the “information system controls”.

- However, as the controls are described under different components of the system of internal control, it conveys the impression that they are distinct. Also, the auditor is required, in paragraph 36, to evaluate the design and implementation of information system controls, and in paragraph 42, to evaluate the design and implementation of controls in the “control activities” component, if they are relevant to audit.
- Greater clarity is hence required on how “information system controls” interplay with or are distinct from controls in the “controls activities” component. Clarity is required on whether controls in the “control activities” component are a sub-set of the “information system controls” and hence subject to evaluation of design and implementation in paragraph 36 of ED-315. If they are a sub-set, this may contradict with paragraph 42 of ED-315 which only requires the evaluation to be performed for those controls which are relevant to the audit.

59. Malaysian Institute of CPAs

The requirements related to the auditor’s identification of controls relevant to the audit have been appropriately enhanced and clarified. However, as indicated in our response to Question 2, we are concerned about the scalability of this standard when applied to smaller or less complex audits in particular when the auditor does not plan to obtain audit evidence from evaluating the design and operating effectiveness of the controls. This may have significant cost implications in performing such audits.

61. PAFA

- PAFA agrees that the requirements related to the auditor’s identification of controls relevant to the audit have been appropriately enhanced and clarified and that it is clear how controls relevant to the audit are identified, including for audits of smaller and less complex entities. There is, however, a concern over the open ended requirement for the auditor to identify controls that he/ she believes are appropriate to evaluate (when identifying controls relevant to the audit) in that it may create inconsistent application thus presenting a challenge from an external monitoring/ inspections point of view.
- A proposed solution to this is to define the terms ‘controls relevant to financial reporting’ and ‘controls relevant to the audit’ in order to enhance the consistent interpretation and application of these concepts.

62. SAICA (South Africa)

- More than two-thirds [69% (79/115)] of the survey respondents predominantly agree that the requirements related to the auditor’s identification of controls relevant to the audit have been appropriately enhanced and clarified (i.e. including with regards to the consolidated list of controls viewed as relevant to the audit). Furthermore, the same percentage (69%) agreed that it is clear how controls relevant to the audit are identified, including for audits of smaller and less complex entities. However, there is also nearly a third (31%) of the survey respondents who predominantly disagree – also refer to our comments in relation to question 5(a), above.

- One respondent commented that paragraph 39(e) is too vague or too broad. Other survey responses, as well as other input we received outside of the survey, alludes to the possibility that this could create uncertainty around auditor work effort, as well as the evaluation of such work effort.
- SAICA believes that the terms 'controls relevant to financial reporting' and 'controls relevant to the audit' should be defined to enhance consistent interpretation and application of these concepts. Suggested wording:
 - Controls relevant to financial reporting – Those controls in an entity's system of internal control that address the achievement of an entity's objectives with regard to the reliability of financial reporting and, therefore, are relevant to the preparation of the financial statements in accordance with the requirements of the applicable financial reporting framework.
 - Controls relevant to the audit – Those controls relevant to financial reporting that address the risks of material misstatement at the assertion level, or that are to be treated as controls relevant to the audit in accordance with the requirements of this ISA or other ISAs.
- SAICA is of the view that the catch-all requirement for the auditor to identify controls that he/ she believes are appropriate to evaluate (when identifying controls relevant to the audit) may be problematic from a consistent application point of view, as well as from an external monitoring/ inspections point of view. Should the proposed definitions (above) be accepted, paragraph 39(e) and its application material could rather be incorporated as general application material to the definition, while sub-paragraphs (a) to (d) of paragraph 39 would be retained in the context of controls which, if not already identified as part of those controls that address potential risks of material misstatement at the assertion level, shall be identified as controls relevant to the audit.

63. SMPC

- The listing of controls relevant to the audit are helpful although the catch all category of 'other controls' without further elaboration is a recipe for stand-off between auditors and regulators. In our opinion, there should be specific acknowledgement that in audits of smaller and less complex entities, in which a fully substantive approach is taken, there are likely to be few controls relevant to the audit that are appropriate to evaluate for their design and implementation. However, it is important also to note that evidence regarding assertions such as completeness and evidence about data integrity more widely, or that recorded transactions cannot be changed, is often missing in some so-called 'substantive' audits.
- Because paragraph 39 (b) determines that internal controls that address significant risks are relevant to the audit, the auditor will be required to test the design and implementation of these controls, even if the auditor does not intend to rely on them and will set control risk at maximum. We agree that this may be appropriate for significant risks that involve complexity so that auditors are in a better position to assess inherent risk, but question whether this is necessary for significant risks not subject to complexity when auditors believe that they can respond to the risks of material misstatement through substantive procedures alone.
- Similarly, we question whether an auditor in an SME environment will always need to understand the nature of controls relating to managements risk assessment process, or its monitoring of controls (para. 39(e)).

Individuals and Others

65. Chartered Accountants Academy (Zimbabwe)

The process of how the auditor identifies controls relevant to the audit has been clarified. The flow chart clearly gives guidance on what to do the results of the auditor's understanding of the system of internal controls, which includes among others the identification of risks of material misstatements at the financial statements level. For smaller and less complex entities, this clearly articulates how the application of these internal controls will ensure that the proper policies, procedures and all relevant documentation is followed by management and allows for the auditor to easily identify discrepancies and errors.

66. FocusRoi Inc.

- Do not disagree with the guidance provided but it will not be liked (or even understood) by auditors of smaller entities who often fail to appreciate the specific audit implications and linkages between an adequate control environment component and the nature and extent of substantive procedures to be performed.
- We also do not understand why assessing design and implementation does not apply to indirect controls such as those found in the control environment and risk assessment. Absence of such controls is often a critical contributor to risk.

67. Lynessa Dias

Agree.

Academics

72. American Accounting Association

- ED-315 paragraphs 39-40 clearly inform the auditor on how to determine controls relevant to the audit. The amendments and explanations are important as extant research results and inspection reports of the Public Company Accounting Oversight Board (PCAOB) show that auditors tend to fall short of understanding the internal control process well enough to fully identify and assess where controls are missing (Brazel and Agoglia 2007; Bierstaker and Thibodeau 2006; PCAOB 2009, 2012, 2013). ED-315 describes various ways to determine relevant controls which is important as controls may differ between smaller, less complex audits and larger, more complex engagements. In some cases, the AEM could be written more clearly and succinctly. For example, the 3rd sentence of paragraph A166 states, "controls are required to be relevant to the audit..." It is clearer and more succinct to say, "controls are relevant to the audit" – which is also consistent with language used throughout this section of ED-315.
- Extant research and the PCAOB have documented concerns about the quality of integrated audits (i.e., how well auditors integrate the audits of internal controls and the financial statements - PCAOB 2012; 2013; Rice and Weber 2012). However, research on how auditors identify controls relevant to an audit is scant. Although it is unclear how successful the proposed revisions will be in practice, the amendments and guidance are needed as studies show that an auditor's inability to properly identify and assess internal controls during an integrated audit is associated with lower financial statement quality (Bhaskar, Schroeder, and Shepardson 2018).