

Responses to ED-315¹
Comments on 'Significant Risks'
NVivo Report 7A
(FOR REFERENCE)

01. Basel

Paragraph A229 states "Routine, non-complex transactions that are subject to systematic processing are less likely to give rise to significant risks because these are likely to give rise to risks of material misstatement at the assertion level that are assessed as close to the lower end on the spectrum of inherent risk." This could be misunderstood and deter the auditor from testing the controls over routine non-complex transactions. We believe that a high volume of routine transactions could, in a number of circumstances, pose a significant risk of material misstatement, e.g. if a high volume of routine transactions outstrips the capacity of the systems to effectively process them. To avoid any misunderstanding, paragraph A229 of ED-315 should explicitly recognize that routine non-complex transactions in some circumstances could also be associated with higher inherent risk.

02. Committee of European Auditing Oversight Body

We have some other concerns about the articulation of the new definition of significant risks and the link to other ISAs. In particular, given the new reference to the upper end of the spectrum of inherent risk in the definition of significant risk, the distinction between the "higher assessed risk of material misstatement" as referred to in ISA 701 (paragraph 9 a) and "significant risks" may cause confusion. We encourage the IAASB to consider the purpose of having two different concepts or to clarify the difference.

04. IAASA

We have some concerns about the articulation of the new definition of significant risks and the link to other ISAs. In particular, given the reference to the upper end of the spectrum of inherent risk in the definition of significant risk, the distinction between the "higher assessed RMM" as referred to in ISA 701 and 'significant risks' may cause confusion. We encourage IAASB to consider the purpose of having two different concepts and if deemed necessary to have both, to clarify the difference.

05. IAIS

In the paragraph A 229 it is noted "Routine, non-complex transactions that are subject to systematic processing are less likely to give rise to significant risks because these are likely to give rise to risks of material misstatement at the assertion level that are assessed as close to the lower end on the spectrum of inherent risk." This could suggest that routine non complex transactions would not be able to raise significant risk and would not require testing the controls in the current period (paragraph A231 and the corresponding flowchart). While we agree that if the volumes are stable and the controls are good then the likelihood of a misstatement might be diminished, the IAASB should ensure that a high volume of transactions that might give rise to a material item is adequately dealt with between ISA 315 and ISA 330.

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

06. IFIAR

Paragraph 16(k) defines a significant risk as a risk where the inherent risk is close to the “upper end of the spectrum”. We recommend the Board provide additional guidance to assist auditors in understanding what is meant by “upper end of the spectrum” and to clarify that “upper end of the spectrum” would not mean that risks are considered significant in only rare circumstances.

07. IOSCO

- We concur with the Board's conclusion to retain the concept of, and the requirement to determine, significant risks given that many of the other ISAs focus on responses to these types of risks. However, we do have concerns that the revised definition of a "significant risk" in the Paper will present application difficulties for auditors in practice.
- Paragraph 16(k) of the Paper defines "significant risk" as an identified risk of material misstatement:
 - For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk [emphasis added] due to the degree to which one or a combination of the inherent risk factors affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should that misstatement occur; or
 - That is to be treated as a significant risk in accordance with the requirements of other ISAs.
- This definition represents a shift from paragraph 4(e) of extant ISA 315 which defined a risk as significant when it required "special audit consideration." We agree with the Board's conclusion to focus the definition of a significant risk on the assessment of inherent risk factors rather than the proposed audit response.
- Notwithstanding our views on the proposed spectrum of inherent risk, we concur with the Board's view expressed in paragraph 56 of the Explanatory Memorandum to ED-315 (Revised) (the Explanatory Memorandum) that defining significant risks as those risks that are "close to" the upper end of the spectrum, as opposed to "at" the upper end of the spectrum allows for more than one risk of material misstatement to be identified as a significant risk.
- However, while paragraph A229 of the Application and Other Explanatory Material provides examples of areas which may rise to the level of a significant risk, our view is that firms would benefit from additional guidance either within the final standard or the Application and Other Explanatory Material for use when considering what risks of material misstatement fall close to the upper end of the spectrum of inherent risk. It is our concern that the notion of "close to the upper end of the spectrum of inherent risk" is too vague and could result in significantly differing judgements made by different auditors even when the profile of a given risk is similar. We are also concerned that there is potential for auditor abuse as it appears that auditors could interpret these requirements in a manner that allows for the minimization of the number of risks ultimately deemed significant.
- We also have concerns regarding paragraph A222 of the Application and Other Explanatory Material, which specifically allows for the possibility that a significant risk assessment be made based on different combinations of the likelihood and magnitude of a potential misstatement. For example, the auditor may identify a significant risk in situations where there is a lower likelihood of a material misstatement but if such a misstatement were to occur, it could be of a very high magnitude. This may be confusing to auditors who view the assessment of significant risk on a

continuum where the designation of a risk as significant results from the likelihood of a misstatement occurring combined with the magnitude of the potential misstatement.

- We believe that it would be useful for the Board to provide additional guidance either in the standard itself or within the Application and Other Explanatory Material to assist auditors in determining whether risk is significant for situations where the risk of material misstatement does not include both a high likelihood and a high magnitude of a potential misstatement.

08. IRBA

- We support the revised definition for significant risks.
- The reference in paragraph A10 to work effort (“including the nature, timing and extent of the auditor’s further audit procedures and the persuasiveness of the audit evidence that will be required to reduce audit risk to an acceptable level”) in explaining significant risk for ISA 315 purposes should be deleted as work effort is after the fact and is a consideration under ISA 330.
- We support the definition in ED-315 where significant risk could result from the degree of likelihood of misstatement OR magnitude of potential misstatement as these can individually or in combination result in inherent risk being close to the upper end of the spectrum.

09. UK Financial Reporting Council

We support the revised definition of significant risk and the related material. We are aware that in practice auditors have not always been consistent in determining which risks of material misstatement are “significant risks”, because the definition of such risks did not describe their nature but rather their implication for the audit (i.e., ‘requires special audit consideration’). The revised definition has significant potential for improving the auditor’s determination of significant risks.

10. AASB of ICAI

We do not support the revised definition, and related material, on the determination of ‘significant risks’. The risks potentially low in likelihood, but for which the magnitude could be very high, should be allowed to be covered under stand-back procedures and should not be included in the definition of significant risks.

11. Australian A&A Standards Board

Reference 1:

Our responses to the questions posed in ED 315’s explanatory memorandum are contained in Appendix 1. Key examples where we consider the current version of the proposed standard may have a negative impact on its understandability and scalability include:

- The terminology used in ED 315 to identify risks could be simplified by only requiring an initial identification of inherent risk and control risk, and then combining these into a defined assessment of risk of material misstatement. The current use of the singular term (“risks of material misstatement”) both before and after the separate assessment of inherent risk and control risk was identified as confusing for many of our stakeholders.
- The requirement to consider the “likelihood or magnitude”, as opposed to the “likelihood and magnitude” when identifying and assessing significant risks we consider may result in unnecessary significant risks being identified.

Reference 2:

We support the definition of significant risk being aligned to the nature of the risk and the susceptibility to fraud or error, and not the auditor's response to a risk, as it is in extant ISA 315. However the definition of significant risk and how this is applied needs further clarity as follows:

- We do not support identifying significant risks based on likelihood of occurrence OR the magnitude of potential misstatement. The IAASB's Explanatory Memorandum details that the IAASB's view is that for risks low in likelihood, but for which the magnitude could be very high if it occurred, it wasn't appropriate to explicitly exclude these from the auditor's determination of significant risks. The AUASB considers risks with a very low likelihood but high magnitude should not automatically be significant risks, and therefore the definition should be changed so auditors consider likelihood and magnitude in combination when determining significant risk.
- The definition of significant risk should be amended to those "at the upper end of the spectrum of inherent risk" and not "close to the upper end of the spectrum of inherent risk".
- Additionally as stated above in question 6(c) additional guidance is required in how to assess where on the spectrum a risk resides, and where a significant risk resides on the scale of likelihood and magnitude.
- Paragraph A10 be enhanced to explain how the "spectrum of inherent risk" works in identifying significant risks. A10 focuses more on the implications for the audit, and not on the identification of significant risks.

12. Canadian AASB

Reference 1:

Significant risks and the reference to magnitude "AND" likelihood - there was concern with using OR in the definition (paragraph 16k), as some would interpret the situation of high magnitude but low likelihood as always being a significant risk, while others would interpret it as a rare circumstance. This would result in inconsistency in practice. Also, an unintended consequence may be an increase in the number of significant risks that auditors identify in their audits, where attention may not need to be directed. [Please see our response to Q6e for further details].

Reference 2:

- In part. We support the change to the definition to include the consideration of inherent risk factors and the degree to which they affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should the misstatement occur. This focus on the nature of the risk is an improvement over the extant definition which focused on the response to the risk.
- However, we are challenged with the reference in the definition of significant risk to high magnitude of potential misstatement OR high likelihood of misstatement. All stakeholders agreed that risks with high magnitude of potential misstatement AND high likelihood of misstatement should be significant risks. There was concern with using OR in the definition (paragraph 16k) without accompanying application material, as some would interpret the situation of high magnitude but low likelihood as always being a significant risk, and some would interpret it as a rare circumstance. This would result in an inconsistency in practice.
- Also, an unintended consequence may be an increase in the number of significant risks that auditors identify in their audits, resulting in inappropriate attention being directed to risks that have a low likelihood of occurring versus other risks. An example of a typically large account balance

with a low likelihood of misstatement is existence of property, plant and equipment. We believe in most cases the auditor would not need to direct significant audit effort to the risk in this assertion. Also, there are other possible impacts on the auditor's work effort and reporting when a significant risk is identified, for example because controls must be tested in the current period when the auditor plans to rely on controls over that risk, reporting key audit matters, among others. We would not expect an item that was previously considered low or normal risk to be identified as a key audit matter simply because the text in ED-315 refers to magnitude OR likelihood.

- We acknowledge there could be circumstances when, in the auditor's professional judgment, there is a significant risk that has high magnitude but low likelihood. However, we are of the view that it should be explicitly stated in the application material that such circumstances are expected to be the exception rather than the norm. More guidance should be provided to assist auditors in determining when such risks require additional work effort.

14. Hong Kong Institute of CPAs

Reference 1:

We agree that the revised definition of 'significant risk' in the context of relative spectrum of inherent risk would enhance auditor's understanding and promote consistency in application. We believe it will be helpful if the application material could provide considerations or scenarios that would trigger the conclusion of a significant risk.

Reference 2:

- Referring to paragraph 57 of the explanatory memorandum, we believe assessing the relative risk spectrum when there is a high magnitude of potential misstatement but a low expectation of the risk occurring requires professional judgment and more guidance and example scenario is needed in this aspect.
- Our SMP stakeholders are of the view that the likelihood of occurrence and magnitude of potential misstatements should be considered collectively to make a conclusion as to whether a risk constitutes "significant risk" as opposed to the use of a rigid definition of having to the word "or" to deem all risks of high magnitude of potential misstatement but low likelihood of occurring as "significant risks".

15. IDW

We agree with the direction of the revised definition and related material for the determination of significant risks. However, as noted from our responses (a) to (d) above, the definition of significant risk should commence with "An identified inherent risk: ..." Furthermore, in line with ISA 200, the term "acceptable level" in paragraph A10 needs to be changed to "acceptably low level". In addition, the words in A10 need to recognize the usage of "inherent risk" as set forth in our responses to (a) to (d) above. We refer to our response to (c) above in relation to our views on how significant risks are determined on the spectrum of inherent risk.

16. Japanese Institute of Certified Public Accountants

Comments on (e) (Significant risk)

- We do not agree that the threshold for significant risk could be the likelihood or magnitude. If significant risks include not only the risks that meet the thresholds of the likelihood and magnitude,

but also those with a high magnitude of potential misstatement but a low expectation of the risk occurring, we are concerned that the risk that should be most closely watched (i.e., the risk with a high likelihood of occurrence and a high magnitude of potential misstatement) may not be watched closely. We also believe that it is inconsistent with the concept of spectrum of inherent risk. We understand that the purpose of introducing the concept of spectrum of inherent risk is to encourage more robust risk assessment according to the nature of risk, to design and perform further audit procedures corresponding to each assessed risk. Further audit procedures for a risk that is less likely to occur but has a high magnitude should be appropriately designed according to the nature of such a risk, and therefore it should be different from the procedures designed for a risk with a high likelihood of occurrence and a high magnitude of potential misstatement, and therefore requires special audit consideration.

- In addition, we propose the following changes.
 - We propose that significant risk should be defined by risk due to error (the first bullet) and risk due to fraud (the second bullet) separately as follows. As footnote 83 indicates, the requirements to which the second bullet relates (i.e., paragraph 27 of ISA 240 and paragraph 18 of ISA 550) are all related to fraud risks. Risk factors differ between the risks due to errors and the risks due to fraud, and therefore the approaches to risk response also differ. We believe that distinguishing between them would lead to more accurate design and performance of further audit procedures. Furthermore, when a fraud risk is identified, the auditor is required to treat it as a significant risk, regardless of the degree of risk. Therefore, fraud risks clearly differ from risks due to errors.
 - For clarity, we suggest adding “material” prior to “misstatement” of the first bullet. We believe the likelihood that a material misstatement will occur is different from the likelihood that a non-material misstatement will occur. Therefore, if the likelihood of a non-material misstatement is high but the likelihood of a material misstatement is not high, we believe it is not necessary to treat it as a significant risk.
 - In addition to describing the nature of significant risks in the definition, the current definition (i.e., “a risk of material misstatement that, in the auditor’s judgment, requires special audit considerations”) should also be retained in the revised definition. The current definition provides an important message that the auditor is required to design further audit procedures that match the risk factors on which the risk assessment is based, which indicates the purpose of the requirement to determine significant risk. Therefore, we believe it must also be retained in the revised definition.

Significant risk –An identified risk of material misstatement that, in the auditor’s judgment, requires special audit consideration. Significant risk includes:

- For which the assessment of inherent risk due to error is close to the upper end of the spectrum of inherent risk due to the degree of which one or a combination of the inherent risk factors affect the likelihood of a material misstatement occurring and the magnitude of potential material misstatement should that misstatement occur; or
- For which the assessed risk due to fraud ~~t~~That is to be treated as a significant risk in accordance with the requirements of other ISAs.

Other extracts related to significant risk:

Controls relevant to the audit

- 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

We support the revised definition and related material on the determination of ‘significant risks’ in that they focus on the substantive nature of the risk itself rather than response to the risk. The use of the word ‘or’ and not ‘and’ broadens the identification of ‘significant risks’ for the auditor to have increased focus not only on risks of material misstatement that are ‘high likelihood, high magnitude’ but also ‘low likelihood, high magnitude’. This has the consequence of widening the identification of significant risks thereby resulting in auditors expending additional audit effort on areas where the auditors would otherwise only perform normal audit procedures. Accordingly, we believe that auditors should have

increased focus on risks for which there is both a high likelihood and high magnitude of material misstatement.

18. Nederlandse Beroepsorganisatie van Accountants

According to us, the definition has been improved. However, the second part of the definition is still circular ('treated as a significant risk in accordance with the requirements of other ISAs'). Furthermore, we wonder whether the 'or' in the first bullet ('or the magnitude...') is correct. In our opinion this should be an 'and'. When both the likelihood and the magnitude are at the upper end, there is a significant risk. We recommend to change this.

19. National Board of Accountants (Tanzania)

Our Suggestion

The definition of significant risk should reflect the risk prioritized from (High Occurrence/High Magnitude) to (Low Occurrence/Low Magnitude).

20. NZ Auditing and Assurance Standards Board

- The NZAuASB supports the revised definition, and related material, on the determination of 'significant risks' noting that supporting the assessment of the likelihood of occurrence of risk of material misstatement can be particularly difficult for auditors in practice. The NZAuASB is therefore of the view that more guidance on how the auditor should assess the probability to support this assessment would be useful.
- In relation to matters presented in paragraph 57 of the Explanatory memorandum the NZAuASB's views are as follows.
- The proposal discussed in the paragraph 57 of the Explanatory memorandum requires the auditor to focus on risks that may have a high magnitude but a low likelihood and also on risks that have a high likelihood but a low magnitude. The NZAuASB does not agree that all of these risks would necessarily achieve the objective of the upper end of the spectrum of risk, rather would broaden the identification of significant risks much further along than at the "upper end" of the spectrum.
- The feedback that the NZAuASB has received on this matter indicates potential for inconsistent application of this requirement in practice.
- While the NZAuASB supports a focus on the nature of the risk rather than the response to the risk it considers that auditors would best focus on risks for which there is a high likelihood AND high magnitude. The NZAuASB also believes further application material in ED-315 and/or additional non-authoritative guidance may be needed to illustrate the practical application of this matter.

21. Altaf Noor Ali Chartered Accountants

Yes.

22. BDO International

- Yes, we welcome the revised definition of significant risks and agree that the previous definition had the potential to result in inconsistent application by auditors. The IAASB's decision to create a definition that is about the actual 'risk' rather than the potential response required by an auditor ('...special audit consideration...') is particularly helpful.

- We also support the decision of the IAASB to have auditors separately determine significant risks, and to retain a separate definition of significant risks, rather than simply to apply the spectrum of inherent risk to determine relative significance.
- The positioning of significant risk, through the definition, as being at the ‘...upper end of the spectrum of inherent risks...’ also makes sense in the context of the spectrum of inherent risk approach that we supported in section 6 (c) of this comment letter.
- In developing our response to this comment letter, one area that did cause much discussion within our organization was the decision to include the phrase ‘likelihood of a misstatement OR magnitude of potential misstatement’ in the significant risk definition in paragraph 16(k) of the exposure draft. This definition appears to be inconsistent with the wording in paragraph A10 which implies an ‘and’ condition rather than ‘or’ through use of the phrase ‘as well as’:

“A10. Significance can be considered in the context of how, and the degree to which, the susceptibility to misstatement is subject to, or affected by, the inherent risk factors, which affect the likelihood that a misstatement will occur, **as well as** the potential magnitude of the misstatement were that misstatement to occur.”

- We believe that a risk of material misstatement should only be significant when it is both likely and material. Further to this issue:
- While we are grateful to the IAASB for the provision of the examples in A222, we did have concerns that these examples, particularly an inherent risk with low likelihood but high magnitude, had the potential to cause greater confusion for auditors and to potentially send the wrong message. This could result in an unnecessary number of significant risks being identified, leading to an audit response in areas that may not be needed and do little to add to audit quality.
- For a significant risk to be at the ‘upper end’ of the spectrum of inherent risk, we took the view that on balance there had to be a reasonable level of likelihood present for something to be considered a significant risk. We do understand that there may be rare occasions when the ‘or’ application is appropriate, but given the level of professional judgment applied to likelihood assessments, we believe that auditors will appropriately deal with those situations. In addition, how firms apply the spectrum of inherent risk concept (whether as a linear, matrix or scoring-based system) is also likely to influence how auditors interpret the importance attached to the use of ‘or’ in the present definition.
- We would support a definition that is more understandable for auditors and that does not introduce an inference that significance is driven by an ‘either/or’ decision. In order to provide clarity, avoid confusion about the ‘or’ decision, and provide auditors with the latitude to exercise their professional judgement (based on the facts and circumstances present in a particular audit), our recommendation would be to use a modified definition of significant risks, as follows:

Significant risk – An identified risk of material misstatement:

- For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk ~~due to the degree to which one or a combination of the inherent risk factors affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should that misstatement occur;~~ or
- That is to be treated as a significant risk in accordance with the requirements of other ISAs. (Ref: Para. A10).

- The suggested definition above would be simpler for teams to apply and would not sway engagement teams to always presuppose that something with minimal likelihood but high magnitude is always a significant risk.
- We would ask that the IAASB consider developing further implementation support materials to help describe how they envisage the identification of significant risks working in practice, in the context of a spectrum of inherent risks. Specifically, if the definition of significant risks remains unchanged, then clarification about whether a significant risk can be identified on either of the upper ends of the likelihood and magnitudes axes when a matrix approach is being applied, would be particularly helpful.

24. Crowe International

The new definition of "significant risk" is an important improvement that will help auditors apply the standard. We agree with the connection that has been given between a significant risk and the spectrum.

25. Deloitte

Reference 1:

Definition of significant risk

The definition of significant risk does not align with the definition of relevant assertion within paragraph 16(h). Paragraph 16(h) outlines that an assertion is relevant to a class of transaction, account balance, or disclosure when the nature or circumstances of that item are such that there is a **reasonable possibility of occurrence of a misstatement with respect to that assertion that is material** individually or in combination with other misstatements; this therefore indicates that risk should be based on likelihood **and** magnitude. In order to align the definitions, DTTL's view is that significant risk should be defined as an identified risk of material misstatement for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which one or a combination of inherent risk factors affect the likelihood of a misstatement occurring **and** the magnitude of potential misstatement, should that misstatement occur (**see response to question 6e in Appendix I**).

Reference 2:

The response in this area should be read in conjunction with DTTL's comments on the Definition of significant risk in our cover letter. DTTL believes that the following changes should be made to the definition of significant risk:

16. (k) Significant risk – An identified risk of material misstatement:

- For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which one or a combination of inherent risk factors affect the likelihood of a misstatement occurring **and** ~~or~~ the magnitude of potential misstatement should that misstatement occur; or
- That is to be treated as a significant risk in accordance with the requirements of other ISAs.

26. EY Global Limited

- No, not entirely. Although we support the concepts in the revised definition, we do have concerns about a particular part of the definition because we believe it will capture many more risks than those at the highest end of the spectrum of inherent risk. As noted in our overall comments, we believe that categorization of a significant risk should be reserved for those risks that are at the upper end of the spectrum due to the degree to which one or a combination of the inherent risk factors affect the likelihood of occurrence **and** the magnitude of potential misstatement should that misstatement occur.
- We also have a concern about the wording of the penultimate sentence in paragraph A167, which states ‘further, the auditor may not have identified any significant risks ...for which it is necessary to evaluate the design of controls’. Requirements in certain other ISAs (for example, paragraphs 26 and 27 of ISA 240, The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements) presume the existence of significant risks in specific situations. Although we accept that such presumed significant risks may not be present on some audits, we are concerned that the example implies that this may be a common occurrence. We suggest that this sentence be qualified as follows: ‘Further, the auditor may not have identified any significant risks, including those presumed by the ISAs as existing on every audit...’

27. Grant Thornton International

- In our view, changing the definition of significant risk did not form part of the original objectives of the project. Not only does it change the notion of a significant risk by creating the implication that practically every audit engagement will have at least one significant risk (in addition to those required by ISA 240), it will result in the creation of more issues than simply adding application material to explain the meaning of “a risk of material misstatement that, in the auditor’s judgment, requires special audit consideration.” For example, it is possible that a risk is identified as being at the upper end of the spectrum of risk, but that it may not require special audit consideration.
- Further, as noted above, we disagree with the proposed definition of significant risk being based on the likelihood **or** magnitude of the risk of material misstatement.
- We are further of the view that the proposed definition of significant risk will result in the following practical implementation issues:
 - It will result in a different definition of a significant risk to that of other auditing standards. For example, the definition of significant risk in PCAOB AS 2110 is consistent with that in extant ISA 315 (Revised). Such differences in definition will result in issues for firms when developing their global methodologies.
 - It will result in complications for the audits of financial statements of groups that cross jurisdictions where significant risk is defined differently. Such differences could result in risks being categorized as significant in one jurisdiction but not meeting the definition in another. For example, under the proposed definition, an inherent risk that has a high magnitude but a low likelihood of occurrence, may meet the definition of a significant risk, but because of its low likelihood, may not be determined to be a risk that requires “special audit consideration” and as such not a significant risk under other auditing standards.
 - “Close to the upper end of the spectrum” may be inconsistently interpreted by firms and may result in risks of the same likelihood and magnitude being categorized as significant by one firm but not as significant by another.

- The spectrum of inherent risk only contemplates risk at the assertion level and as such does not take into account financial statement level risks, which would also need to be identified and assessed. As currently proposed, application of the proposed definition of significant risk would result in the significant risk of management override of controls, required by ISA 240, being the only financial statement level risk meeting the definition.
- Overall, we are of the view that the proposed change in the definition of a significant risk will have a negative impact on audit quality.

28. KPMG IFRG Limited

Reference 1:

- We recognize that the IAASB has considered whether to retain the concept of significant risk, rather than creating an approach that guides the auditor to assess where on the spectrum of risk a matter lies and then to design a response accordingly, using professional judgement. We support the IAASB's conclusion to retain the concept on the basis that other ISAs contain the concept of significant risk.
- Furthermore, we do believe that some sort of "threshold" is needed in order to provide auditors with a clear framework to assess the severity of risks, and to trigger certain audit responses on a consistent basis, with this threshold being that a risk is assessed as significant.
- In relation to this, we have concerns regarding the IAASB's preliminary conclusion that significant risks are best represented by a high likelihood of occurrence OR high magnitude of potential misstatement, rather than AND, and the auditor will apply their professional judgement as to whether a matter is actually a significant risk. We recognize the IAASB's intention not to explicitly exclude risks that may potentially be relatively low in likelihood but for which the magnitude could be very high if the risk were to crystallize. Furthermore, we acknowledge the IAASB's objective to promote careful consideration of matters such as fraud, compliance with laws and regulations, including regulations around money laundering, bribery and corruption, as well as consideration of the outcome of potential litigation, which may have a very high magnitude and for which sufficient appropriate audit evidence is needed in order to properly assess the likelihood of occurrence.
- However, we are concerned that, as drafted, the ED appears to suggest that significant risks may be represented by matters that have a high magnitude, but a low likelihood (i.e. exceeding the threshold of more than remote), which would result in an audit response that includes increased focus on these matters. We highlight that fraud considerations are addressed elsewhere, including within the inherent factors in the ED, as well as by the specific requirements of ISA 240. We also believe that in respect of other areas such as litigation and claims, and compliance with laws and regulation, there may be inherent uncertainty as to the "likelihood" of a material misstatement arising in respect of such matters, which necessarily results in increased auditor focus. However, if an auditor is able to determine that there is a low likelihood of such a matter resulting in a material misstatement, then we do not believe it to be appropriate to require that such a matter be treated as a significant risk. As a result of the above, we recommend that the IAASB amend the ED to refer to a high likelihood of occurrence AND high magnitude of potential misstatement.

Reference 2:

We support revisions to the definition that better focus on a significant risk being close to the upper end of the spectrum of inherent risk, rather than on the response to the risk alone. It allows for greater judgement of the auditor, and better enables compliance with the requirement (in the extant standard at paragraph 27) to identify significant risks excluding the effects of controls, i.e. based on the inherent risk alone. In terms of the description of the spectrum of inherent risk, and how significant risks are represented on the spectrum, we refer to our response to question 6(c), above.

29. MNP LLP

Reference 1:

Finally, we think that while ED-315 clarifies significant risks, we are concerned that the concept may continue to be inconsistently applied among auditors. ED-315 states that a significant risk could be represented on the spectrum of inherent risk by either a high likelihood of misstatement or a high magnitude of potential misstatement. However, it does not appear that ED-315 provides examples of when a significant risk results from only one of either a high likelihood of occurrence or a high magnitude of possible misstatement. To promote better understanding and consistency of application, we recommend that examples of various possible significant risk scenarios be added to ED-315.

Reference 2:

Yes, overall, we support the revised definition, and related material, on the determination of 'significant risks'. However, we are concerned that the application of this definition may be difficult in some circumstances as it is not clear when a significant risk results when only one of likelihood or magnitude is assessed as high on the spectrum of inherent risk. We recommend adding examples of this concept to ED-315 to provide clarity to auditors in applying the revised definition.

30. PwC International

- We do not agree that significant risks should be defined by reference to likelihood "or" magnitude, which will result in items that do not represent a significant risk being unnecessarily defined as such, for example, certain classes of transactions, account balance or disclosure that may be highly material but for which the likelihood of misstatement is very low.
- We do not believe that balances that simply have a high magnitude, of themselves, sit at the upper end of the spectrum of inherent risk - for example, a significant fixed asset, for which the risk of misstatement is low, should not be captured by the definition of a significant risk. In fact, the proposed definition of significant risk that includes stating "or the magnitude of potential misstatement" could be interpreted as implying that any material balance in the financial statements is at the upper end of the spectrum of inherent risk simply because if misstated, the financial statements could be materially misstated.
- The category of "significant risk" is used in the ISAs to set requirements for those areas in the audit that warrant greater focus and more persuasive evidence. Other ISAs (in particular ISA 330) set out the additional work effort that is required in relation to such risks, including, when the auditor plans to rely on controls that address a significant risk, requiring that those controls be tested in the current period. Such requirements are warranted to reduce the risk of material misstatement for those areas in the audit subject to higher inherent risk to an acceptably low level. It is one of the ways that the ISAs demonstrate how to design an appropriately risk-based audit with more audit attention on areas of heightened risk. In our view, however, these

procedures are unnecessary to reduce risk to an acceptably low level for classes of transactions, account balances or disclosures that may be material, even highly material, but that have a low likelihood of misstatement. In fact, doing so may risk distracting auditor attention away from areas with a higher likelihood, and reducing skepticism by suggesting that all material items are, in a sense, worthy of “equal” audit work.

- If the IAASB believes that there are specific matters that should be considered in relation to material balances that would not be addressed by complying with the requirements other than those addressing significant risks, those matters should be articulated separately in requirements specifically targeted at that category.
- If the intention of the change is to seek to address populations that may seem to be low risk at a transaction level, but when aggregated into a single population have a heightened risk profile, then we would instead propose that additional application material make this specific point rather than amending the definition to be likelihood “or” magnitude.
- We also believe the Board needs to make clear if the intent of the requirements is that at least one significant risk would always be identified. We do not believe that is the intent, nor that this is the case, but the recent webinars have not helped our understanding in this respect.

31. RSM International

- We support the concept that a significant risk is toward the upper end of the spectrum of inherent risk and, in our view, the new proposed definition of ‘significant risk’ is an improvement on the existing one and may help to reduce inconsistencies in practice.
- However, we are concerned that the requirement to consider risks with a high magnitude **or** likelihood may result in more significant risks being identified than is currently the case and where little value is added by the additional work required. For example, risks with low likelihood but, were they to occur, high magnitude and vice versa. An extreme example could be a natural disaster which may be unlikely to occur but would be devastating for the entity.
- We note that the proposed definition in paragraph 16(k) is inconsistent with the description provided in paragraph A222, which states, “the higher the combination of likelihood **and** magnitude, the higher the inherent risk,” and, “Significant risks, which are identified in accordance with paragraph 49, are those close to the upper end of the spectrum of inherent risk.” We believe these concepts should be aligned.
- The third sentence in paragraph A10 states, “The significance of a risk of material misstatement at the assertion level is considered in the context of the implications of the assessment of its inherent risk for the performance of the audit, including the nature, timing and extent of the auditor’s further audit procedures and the persuasiveness of the audit evidence that will be required to reduce audit risk to an acceptable level.” This seems to be inconsistent with the definition of significant risk in paragraph 16(k) in that the definition refers to the inherent risk’s position on the spectrum of inherent risk, whereas paragraph A10 seems to suggest that the determination is related to the eventual audit procedures to be performed to address the risk. This represents a different concept that should not, in our view, be introduced in an application paragraph. We believe this will create confusion and inconsistency when determining which inherent risks are significant risks.

32. Office of the Auditor-General of Alberta

In our view, risk assessment would be more consistent if the concept of significant risk is removed. It is conceptually difficult to distinguish significant risk from the concept of high inherent risk. There is a practical matter in that ISA 330 does not allow the auditor to use evidence obtained in prior periods for significant risks, but an editorial change to “inherent risk other than low” would achieve the same result.

33. Office of the Auditor-General of Canada

Yes, we support the revised definition and related material on the determination of significant risk. Given the degree of professional judgment involved in concluding where on the spectrum of inherent risk an assertion should be assessed, we feel the definition of significant risk provides the latitude necessary to properly conclude.

35. US Government Accountability Office

We support the revised definition, and related material, on determining significant risks. We agree that significant risks could include risks that are potentially low in likelihood but for which the magnitude of misstatement could be very high if they occurred.

36. Swedish National Audit Office

Yes, we support the new definition of significant risk.

37. Wales Audit Office

- The definition of ‘significant risk’ has been a significant difficulty in the application of the current Standard.
- Unfortunately, we do not consider that the proposed revised definition is an improvement. We believe that its theoretical basis will continue to render practical application particularly difficult.

38. ACCA-CAANZ

Reference 1:

The requirements and application material require the auditor to assess inherent risk by reference to likelihood and magnitude. However, a ‘spectrum’ indicates a single dimension. The IAASB does not explain how it intends practitioners to resolve the two dimensions of likelihood and magnitude into a single scale of inherent risk. Accordingly, we anticipate that practitioners will adopt a range of approaches to determine a spectrum, leading to inconsistent identification and assessment of risk. Further guidance on the documentation requirements in relation to likelihood and magnitude assessments and how are these linked to the spectrum of inherent risk would be helpful.

Reference 2:

The issues raised in our response to Question 6(c) also apply to the determination of significant risk. If the IAASB intends that high magnitude, low likelihood risks should be assessed as significant risks, it could make this clear by adding an additional bullet point to paragraph A229.

39. Accountancy Europe

- We welcome the concept of a 'spectrum of risk', but ED 315 does not explain it well, since this new notion is introduced by way of inclusion in a definition. Better explanation will be needed to drive consistent application by auditors not already using this in their methodologies.
- Conceptually, we support retaining the notion of 'significant risk', but when using the 'spectrum of inherent risk' in risk assessment, the notion of 'significant risks' may be seen as redundant. However, we appreciate the role that significant risk plays. Not retaining this notion would cause disruptions in the suite of ISAs. Because the concept is a 'bright line' to both auditors and regulators, defining 'significant risks' as risks closer to the upper end of the 'spectrum of inherent risk' is not sufficient to sort this issue and needs further consideration. It is unclear though, how ED-315 applies to the rest of the spectrum of inherent risk, after having identified significant risks.
- With regard to the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement when assessing inherent risks, the standard should make it clearer that the auditor applies professional judgement to the individual engagement circumstances when determining whether to place an inherent risk closer to the upper end of the 'spectrum of inherent risk'. It would also be helpful if the IAASB could clarify what is meant by the notion of "magnitude" (which could be interpreted as doubling up on the concept of materiality).
- A possible circumstance or event that could give rise to a material misstatement even with a low likelihood of occurrence might still be relevant, for example in the extreme, if it would have devastating impact, potentially affecting the entity's ability to continue as a going concern. This is noted as not being excluded in the Explanatory Memorandum, but it should be made clear in the standard itself. If the Board's intention is that risks with a potential high magnitude but with a low likelihood of occurrence should always be assessed as significant risks, then the standard needs to be clearer on this. Considering the objective of consistent application, practitioners would need some guidance or benchmark in determining the level of likelihood that would make a high magnitude risk a significant risk.
- The standard should generally discuss the approach to be taken where only one of the two criteria is assessed as high (high likelihood or high magnitude), and also make it clear as to the impact where no risks are identified. This is fundamental in having a better-quality risk assessment process that results in addressing all relevant risks.

40. AICPA

Paragraph 16(k) — We continue to believe that "significant risk" should be the product of the likelihood **and** magnitude of a potential misstatement. For example, we do not believe that a risk of material misstatement with a high likelihood of occurrence, but which has a remote likelihood of being material (both quantitatively and qualitatively) would ordinarily be assessed as a significant risk. Conversely, a potentially material misstatement with a remote likelihood of occurrence would not ordinarily not be assessed as a significant risk. We believe concluding either of these situations may result in a significant risk is inconsistent with the "reasonable possibility" concept which is core to ED 315's definition of relevant assertions. Also, we recommend that the application material emphasize that the assessment of likelihood is done without consideration of controls, for purposes of this identification.

41. Center for Audit Quality

- The definition of Significant Risk in paragraph 16(k) refers to the likelihood of a misstatement occurring **or** the magnitude of a potential misstatement (emphasis added). We recommend that

the definition be revised to refer to the likelihood of a misstatement occurring **and** the magnitude of a potential misstatement. As an example, we do not believe that a risk of material misstatement with a high likelihood of occurrence but a remote likelihood of being material (both quantitatively and qualitatively) should be assessed as a significant risk. Conversely, a potentially material misstatement with a remote likelihood of occurrence should not be assessed as a significant risk. We support the application guidance in paragraph A222 explaining that positioning on the spectrum of inherent risk is determined by both the likelihood **and** magnitude (emphasis added), and that significant risks are those close to the upper end of the spectrum of inherent risk.

- The third sentence in paragraph A10 could be viewed as inconsistent with the definition of significant risk in paragraph 16(k) of the Exposure Draft. It is circular and could imply that the auditor also should consider whether a risk is significant based upon the potential audit procedures to be performed when in fact the assessment of risk informs the audit response. We recommend removing this sentence.

42. Chartered Institute of Public Finance & Accountancy

The revised definition of significant risk is probably an improvement.

43. CPA Australia

The definition of “significant risk” links it to the likelihood or magnitude of potential misstatement, however this suggests that the size of the balance or transaction alone could lead to significant risk. Whereas we suggest that it should be the combination of likelihood and magnitude which will determine significant risk.

44. EFAA

We have no comments.

45. Finnish Association of Authorised Public Accountants

It is not clear how significant risk (at the high end of the spectrum) does differ from other risks at high end of the spectrum.

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

Absolutely agree. The use of the combination of High magnitude and/or High likelihood of occurrence helps in a relevant way to define when an inherent risk is significant. The issues presented in paragraph 57 of the Explanatory Memorandum are appropriate to achieve an adequate understanding of the use of the inherent risk spectrum. Anyway, we understand that it would help to achieve greater consistency in practice if guidelines were established to categorize the probability of occurrence and the magnitude of impact in a graphic format

47. FSR Danske Revisorer (Denmark)

- We do not agree that significant risks should be defined by reference to likelihood “or” magnitude, which will result in items that do not represent a significant risk being unnecessarily defined as such, for example certain classes of transactions, account balances or disclosures that may be highly material, but for which the likelihood of misstatement is very low.
- This would for example, imply that any material balance in the financial statements would be at the upper end of the spectrum of inherent risk simply because, if misstated, the financial

statements could be materially misstated. An assessment of the probability of misstatement does not appear to be taken into account.

- In our view, this could distract the auditor's attention away from areas of high inherent risk and reduce skepticism by suggesting that all material items need to have the same degree of attention.

48. Interamerican accounting association (South America)

Yes, we support. The spectrum mentioned in the question of letter c) of this point 6, mentioned in paragraph 57 of the Explanatory Memorandum to ED-315 (Revised), from our point of view, of how the significant risks in said spectrum are determined for the inherent risk it is appropriate from the guiding perspective. We agree with the position of the IAASB that the significant risk could be considered as possible from the point of view of the occurrence of a misstatement or the magnitude of such a possible misstatement.

49. Instituto dos Auditores Independentes do Brazil

The focus of the spectrum in 'likelihood or magnitude' should be changed to 'likelihood and magnitude', because auditors may struggle to understand the different application of each one and if both of the conditions need to exist in order to determine that there is an SRMM.

51. Institute of Chartered Accountants in England and Wales

The proposed definition of 'significant risk' is an improvement on the extant definition which leads to inconsistencies in practice. It should be easier to apply, but audit regulators should be aware that a different set of significant risks may be identified using this definition. We note in our answer to part (c) of this question that some risks currently caught may not meet the revised definition, depending on how the proposals are interpreted. The Explanatory Memorandum notes that risks with high magnitude but low likelihood are not excluded, but the lack of clarity in the standard itself is bound to lead to inconsistencies. IAASB needs to be explicit: are both conditions required for a risk to be caught, or just one? We are aware of different interpretations of IAASB's assumed intent.

52. Institute of Chartered Accountants (Ghana)

We support the revised definition and related material on the determination of significant risk but it is not conclusive. Though the definition acknowledged a significant risk could result from the degree of likelihood of misstatement or magnitude of misstatement, it did not conclude on the matter but laid a caveat for consulting. The removal of the focus from the response but rather to where the risk is situated on the spectrum of inherent risk seems to be more intuitively understandable and consistent. In addition, the clarification of **either** a high likelihood or high magnitude (impact) has provided further guidance on the understanding of significant risk.

53. Institute of Chartered Accountants of Pakistan

- We support the definition of significant risk being aligned to the nature of the risk and the susceptibility to fraud or error, and not the auditor's response to a risk as it is in extant ISA 315.
- In relation to the definition of significant risk and the matters presented in paragraph 57 of the IAASB's Explanatory Memorandum, we consider that risks with a 'very low likelihood' but 'high magnitude' should not be automatically significant risks, and therefore the definition should be changed so auditors consider likelihood and magnitude in combination when determining

significant risk.

54. Institute of Chartered Accountants of Scotland

In general, we support retaining the notion of 'significant risk', but when using the 'spectrum of inherent risk' in risk assessment, the notion of 'significant risks' may be seen as redundant. However, we appreciate that not retaining the notion of 'significant risks' would cause disruptions in the suite of ISAs. That said, we believe that defining 'significant risks' as risks closer to the upper end of the 'spectrum of inherent risk' is not sufficient to address this issue and may need further consideration.

55. Institute of Chartered Accountants (Zimbabwe)

Yes. The new definition will include additional risks that were once scoped out due to the definition. By inclusion of the term spectrum in the definition, the likelihood of occurrence and magnitude is also considered in coming up with a significant risk.

57. Institute of Public Accountants

Reference 1:

The IPA has concerns with the concept of a "spectrum of inherent risk" in the context of audit. A spectrum of risk implies a graduated scale of risk and a level of precision and granularity not evident in most audit risk processes. Furthermore, audit risk response is not graduated but rather represents discrete responses. Audit risk is most often considered as discrete level e.g. high, medium and low and the audit response is calibrated to those discrete levels. Many audit procedures do not have the characteristics to respond to the level of granularity.

Reference 2:

Subject to IPA's concern with the term "spectrum of risk", the IPA believes it would be useful to include material similar to that in paragraph 57 of the Explanatory Memorandum in the application guidance to the standard.

58. Institute of Singapore Chartered Accountants

Determination of Significant Risks

- We are of the view that, in the determination of significant risks, both the likelihood of a misstatement occurring, and the magnitude of potential misstatement should be considered. The combination of likelihood and magnitude will help determine whether the assessed risks are close to the upper end of the spectrum of inherent risk and are therefore significant risks. Based on the proposed definition of "significant risk" in paragraph 16(k) of ED-315, it would appear that a high likelihood or a high magnitude alone can result in a significant risk.
- There are many possible risks that an entity would face that may have severe consequences. Taking into consideration that the determination of significant risks only considers inherent risks and does not take into account related controls, the proposed definition of "significant risk" may lead to a disproportionately high number of significant risks being identified.

59. Malaysian Institute of CPAs

We do not support the revised definition of "significant risks", which is defined by reference to likelihood or magnitude. Under the revised definition, it would be implied that any material balance (say a

significant PPE) on the financial statements would be in the upper end of the spectrum of inherent risk simply because if the balance is misstated, the financial statements could be materially misstated notwithstanding that the risk of misstatement of that balance is remote or low. This would inevitably scope in more 'significant risks' which will result in greater audit efforts to dispose of such risks

60. New York state society of CPAs

We support the revised definition of significant risks. However, if the likelihood of occurrence is considered to be remote, our concern is that the exposure draft, as currently written, may not be clear to all users and may result in misapplication of the standard. We would recommend that this paragraph be further clarified and addressed in a revised definition.

61. PAFA

PAFA supports the revised definition, and related material, on the determination of 'significant risks' on the basis that it appropriately describes how a significant risk should be determined therefore making it more conceptually sound.

62. SAICA

- 82% (82/100) of the survey respondents indicated that they agree with the revised definition of 'significant risk'. SAICA supports this view; we believe that the revised definition is conceptually more sound than the definition in the extant standard; it more appropriately describes how a significant risk should be determined.
- 79% (76/96) of the survey respondents predominantly agree that sufficient guidance has been provided to assist the auditor with the determination of significant risks. Although half (38) of the 76 survey respondents concerned only indicated their level of agreement at "4", using the identified scale of 1 to 6. This could be an indication that they may not be totally convinced yet and it could be a function that this is still new and some bedding-down of the new definition and its application will be required.
- An additional perspective is provided by the following question that was included in the SAICA survey, "Do you believe that the revised definition and related material under the new standard will result in any major differences in practice relating to the nature or number of significant risks identified on audits, compared to the extant standard?"
- **Mixed views** were expressed, with 29% (29/101) of survey respondents answering 'Yes', 37% (37/101) answering 'No' and 35% (35/101) indicating that they are unsure.
- A vast majority [80% (81/101)] of survey respondents indicated 'Yes' in terms of agreeing with the approach that when it comes to determining significant risks, it is necessary to acknowledge that certain significant risks could result from high magnitude of potential misstatement, even though the likelihood of occurrence may be low. Significant risks therefore do not necessarily only result from the combined consideration of likelihood x magnitude.
- Based on the survey results, above, including individual text comments of survey respondents and further deliberations, we are of the view that the IAASB should give further consideration to whether the description of 'close to the upper end' of the spectrum of inherent risk is sufficiently clear, including whether this could have consequences in terms of auditors either unnecessarily identifying more significant risks, or unintentionally or intentionally identifying fewer significant risks, compared to the results in practice under the extant standard. The issue could be

addressed to an extent by expanding the application material in paragraph A229, for example, by also contrasting it to a situation where risks of material misstatement are assessed more towards the higher end on the spectrum of inherent risk, but still not reaching the level of being assessed as significant risks.

- The application material does not describe the intention of the IAASB's choice of using the words 'likelihood or magnitude' instead of 'likelihood and magnitude' in relation to the determination of significant risks (refer to paragraph 49 and A229-A231). The application material should be expanded to describe this more fully, including that a significant risk may result from a combination of a very high magnitude and a lower likelihood (with an example), as well as confirming that the combination of 'magnitude' and 'likelihood' could also still give rise to significant risks (i.e. resulting in inherent risk being close to the upper end of the spectrum). There was a suggestion that the visual presentations used in the IAASB webinar would also go a long way in clarifying how 'magnitude' and 'likelihood' are applied in the context of determining significant risks.

63. SMPC

We support the revised definition, and related material, on the determination of 'significant risks', which should be more straightforward to apply in practice. We agree that significant risks should not be limited to risks with a high magnitude and likelihood. Similar to assessment of inherent risks, we believe that the likelihood of occurrence and magnitude of potential misstatements should be considered collectively to make a conclusion as to whether a risk constitutes "significant risk" as opposed to the use of a rigid definition. In our view, there is a need for the IAASB to be explicit about what it intends in regard to the auditor's approach to likelihood vs likelihood or magnitude, since we are aware of different interpretations of the IAASB's assumed intent. Lack of clarification in this area will lead to inconsistent application. For example, the possible impact on an entity's ability to operate as a going concern is a factor that could be highlighted in this regard, to clarify that even a low likelihood can be a trigger.

65. Chartered Accountants Academy (Zimbabwe)

The definition of significant risks currently focuses on auditor response rather than the nature of the risk. The new definition will include additional risks that were once scoped out due to the definition. By inclusion of the term spectrum in the definition, the likelihood of occurrence and magnitude is also considered in coming up with a significant risk.

66. FocusRoi Inc.

Yes, we are in full support but fail to understand why high magnitude is deemed significant by itself and therefore more important than likelihood of occurrence.

67. Lynessa Dias

I agree with the discussion material and definitions of significant risks in the exposure draft. Both the magnitude and likelihood of potential misstatement as a result of outliers in the normal course of business processes can lead to a significant risk to the overall financial position of an entity. However, the impact of magnitude and likelihood of risk occurrence can be better assessed by focusing on the risk of material misstatements in financial statements in order to achieve a fair representation of business results. An in-depth assessment of the susceptibility of all business processes to fraud would provide a complete evaluation of an entity's inherent risks but the cost of time and resources deployed may outweigh the benefits. Materiality levels are relative to the scale of entity-wide operations and an

assessment of significant inherent risks should also be relative to the operational scale. This would sharp focus audit resources to effectively and efficiently execute on significant risks assessed in an audit plan.

69. Dr. Richard Wittsiepe

Maintaining the concept is a welcome thing. The question arises as to whether the catalog should be expanded in order to more clearly point out special risk situations. In my view, the necessity comes from the fact that the scope of ISA 315 has increased considerably, and important risk aspects may possibly be lost in the full text because the connections are no longer easily recognized because the catalog is split up throughout the text. The section starting at A229 provides the opportunity to point out these items. They are primarily two items:

Fair value valuations

- If the financial statement framework allows fair value valuations, and the valuation is done by model calculations, some of which are conducted by external consultants and not by the company itself, there is a risk of incorrect balance sheet recognition, especially when the balance sheet items are significant. This risk only comes from applying the model calculation because the model calculation is used when information on valuation cannot be obtained due to stock exchange or market prices or prices obtained from stock exchanges or markets. These "level 3" valuations can hardly be judged objectively.
- The IFRS draft on the conceptual framework dated March 2018 contains items that in my view should be included in ISA 315 if a significant risk as described above is determined based on fair value valuations.
- In IFRS draft number 5.14 "Existence uncertainty," it is pointed out that inflows with a low probability and high spread do not constitute relevant information for valuations, and thus the requirements for an asset are not met. This would result in capitalization being eliminated.
- These items are further explained in 5.15 to 5.17 of the draft.
- In the existing ISA 315 draft, the aspects are scattered. We find the notice about fair value information in A142. In A214, there is a notice about the sensitivity analysis that is supposed to verify the underlying assumptions for valuation procedures.
- In A229, accounting estimates with high valuation uncertainty, complex models, and complex data collection are stated as significant risks, but that is not sufficient in my view. That is too unclear.
- The risk situation from applying fair value valuations with the help of complex model calculations should be very clearly pointed out, and if the sensitivity analysis or other methods produce a high degree of uncertainty and large ranges, the test used for the issue of whether something is an asset or a liability under the financial framework concept that is used should be expressly indicated as an item in the audit procedures to be conducted.
- This applies to the entire area of public sector entities, and we must assume that these valuation methods will increase as we bring in experts and service providers in the future.

Revenue recognition

- The same applies to the item “revenue recognition.” Here as well, a significant risk should be specifically stated when complex model calculations are used to enter revenue.
- These two items should be included in a focused way under significant risks starting with section A229.