

**Responses to ED-315<sup>1</sup>**  
**Comments on 'Spectrum of Risk'**  
**NVivo Report 9A**  
**(FOR REFERENCE)**

**01. Basel**

Overall, we support the IAASB's initiatives to improve the auditor's risk assessment procedures. In particular, this is the case because of the interplay between ISA 315 and ISA 540 (Revised),<sup>2</sup> which is of utmost relevance for us. As we believe the enhancements in ED-315 are developments in the right direction and we strongly support them.

The following improvements are particularly important to us:

- Introduction of new concepts such as inherent risk factors and spectrum of inherent risk;
- ...

**02. Committee of European Auditing Oversight Body**

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

**04. IAASA**

The ED introduces the concept of a spectrum of risk. This is defined, but not mentioned elsewhere in the requirements. We would support adding a requirement in the standard for the auditor to assess where each risk belongs in the spectrum of risks with appropriate documentation of this assessment.

**05. IAIS**

The IAIS is supportive of the IAASB's initiatives on improving the auditor's risk assessment procedures. These improvements are particularly important in the following areas:

- Introduction of new concepts of inherent risk factors and spectrum of risks.

**06. IFIAR**

We are supportive of the Board's introduction of the concept of a spectrum of risks. To support the application of this concept, we would suggest adding a requirement in the standard (and corresponding application guidance) to assess where each risk belongs in the spectrum of risks with appropriate documentation of this assessment.

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

## 07. IOSCO

- Paragraph 5 of the Paper introduces the concept of the "spectrum of inherent risk" as "the degree to which inherent risk varies." We agree that a spectrum is an appropriate analogy as the assessment of inherent risk involves numerous considerations and thus an inherent risk can have varying degrees of severity. We are, however, concerned that the Paper does not provide sufficient application and other explanatory material to appropriately promote consistent application by auditors.
- As an example, we understand that many auditors have already developed their own categories and metrics related to the assessment of inherent risk. Paragraph A225 of the Application and Other Explanatory Material provides for auditors to develop their own categories along the spectrum of inherent risk which could vary from one auditor to another (e.g. a numerical scale of 1-10 or a low/medium/high scale). Is this aligned with the Board's desire to drive consistency in the identification of significant risks? Did the Board consider introducing defined categories of risk to be consistently applied by all firms?
- Despite the introduction of a spectrum of inherent risk, the Paper ultimately still results in the identification of only two binary levels of risk; significant or not significant. It is unclear how the Board believes the nature, timing and extent of audit procedures should vary for risks identified on the spectrum that have not been deemed significant. Even if consistency in the classification of risks is achieved through the implementation of ISA 315 (Revised), the responses by auditors in terms of the nature, timing and extent of audit procedures may differ due to the principles-based nature of ISA 330, The Auditor's Responses to Assessed Risks (ISA 330).
- We do not believe the limited changes proposed to ISA 330 are sufficient to address the significant changes to ISA 315 (Revised) and would encourage the Board to consider revising ISA 330 and whether a revised ISA 330 should be issued at the same time as ISA 315 (Revised).

## 08. IRBA

- We support the IAASB's introduction of the concept of a spectrum of inherent risks. To ensure that this concept is applied consistently by auditors, we recommend that further application material be included to assist auditors with understanding and applying this term.
- We recommend that the IAASB provides application material to assist auditors in understanding what is meant by "upper end of the spectrum", and to also clarify that "upper end of the spectrum" would not mean that risks are considered significant risks only in rare circumstances as some auditors may perceive "upper end" as being a rare occurrence.
- Further, the IAASB should consider including application material to demonstrate, through examples, what is meant by "likelihood of a misstatement occurring" and "magnitude of potential misstatement should the misstatement occur" and how these can result in the "upper end of the spectrum of inherent risk". This will also be supported by the stand-back requirement in paragraph 52 of ED-315.

#### 09. UK Financial Reporting Council

- The explicit acknowledgement of the spectrum of inherent risk in ED-315 which has the potential for significant improvement in achieving consistency in the identification and assessment of the risk of material misstatement.
- We strongly support the more explicit acknowledgement of this concept in ED-315 (i.e. enhancing that already briefly described in ISA 200). It has the potential for significant improvement in achieving consistency in the identification and assessment of the risk of material misstatement. It should also address the matter raised in the project proposal regarding the potential over-emphasis of work effort in relation to significant risks at the expense of those risks of material misstatement that are not determined to be a significant risk. As noted earlier, a greater understanding of the spectrum of inherent risk will also help auditors tailor further audit procedures more effectively.

#### 10. AASB of ICAI

- In our view, the introduction of the 'spectrum of inherent risk' **will bring inconsistency** in the identification and assessment of the risks of material misstatement, including significant risks.
- When a significant risk is identified, the auditor would be required to design audit procedures for obtaining sufficient appropriate audit evidence in relation to the risks at the assertion level. These procedures are likely to be similar/ same irrespective of where the risk is placed on the spectrum of inherent risk.

#### 11. Australian A&A Standards Board

- The AUASB is supportive of the introduction of the "spectrum of inherent risk" concept, and of auditors considering how inherent risk factors individually or in combination, increase inherent risk to varying degrees. The consideration of inherent risk factors and the concept of the spectrum of inherent risk help auditors consider the susceptibility to misstatement and the risks, when assessing inherent risk.
- However, we believe more guidance would be beneficial to assist auditors determine at which point on the spectrum a risk resides. Refer Question 6(e) for further comments on the definition of significant risk.

#### 12. Canadian AASB

- Yes. We support the introduction of a spectrum of risk. Stakeholders said it aligned with how they were applying the concept of risk in practice under extant 315 and the material in ED-315 made the concept explicit. The spectrum of risk is an improvement over the distinction of significant risk vs. not significant. This is a step towards improving audit quality.
- However, we believe the "spectrum of risks" as currently articulated in the proposals could result in inconsistencies in practice, especially close to the lower end of the spectrum. Some practitioners interpreted the proposals in a way that as soon as the threshold of a remote likelihood of material misstatement was crossed (i.e., there was a relevant assertion), the "starting point" would be an inherent risk that is low or lower. The inherent risk factors and the combination of likelihood and magnitude would then help the auditor determine if the risk should move up on the spectrum. Other practitioners interpreted that a relevant assertion would equate to a "starting point" of medium or moderate inherent risk. We recommend the IAASB provide guidance for auditors to relate the concept

that is in the definition of relevant assertion of “reasonable possibility of occurrence of a misstatement” with the spectrum of inherent risk.

### 13. CNCC-CSOEC

- The IAASB has introduced the concept of “spectrum of risk” to facilitate greater consistency in the auditor’s identification and assessment of risks of material misstatement by providing a frame of reference for the auditor’s consideration of the likelihood and magnitude of possible misstatements and the influence of the inherent risk factors. However, we think that the concept “spectrum of risk” is not sufficiently explained in the ED-315. It has been introduced by the way of inclusion in a definition, i.e. definition of significant risk as risk close to the upper of the spectrum of inherent risk. We consider that the ED-315 should further clarify the concept of spectrum of risk and how ED-315 applies to the rest of the spectrum of inherent risk (i.e. risk not close to the upper of the spectrum).
- In addition, we believe that the IAASB could clarify the following:
  - the use of the professional judgment when the auditor determines to place an inherent risk closer to the upper end of the “spectrum of inherent risk”;
  - the notion of “magnitude” and its potential correlation with the concept of materiality.

### 14. Hong Kong Institute of CPAs

We believe the "spectrum of inherent risk" will facilitate greater consistency.

### 15. IDW

- We believe that the introduction of the concept of a spectrum of inherent risk will assist auditors in assessing inherent risks (rather than risks of material misstatement: note that in the term “spectrum of inherent risk”, the spectrum relates to inherent risk – not risk of material misstatement), but will have no impact on their identification (see our response to (d) for why this is the case). Furthermore, such introduction will also assist auditors in determining when inherent risks (rather than risks of material misstatement) are significant risks. We also agree that to do this, auditors need to assess the likelihood and magnitude of potential misstatement. We surmise that the guidance will assist auditors in being more consistent in such risk assessments as well.
- However, in addition to the use of terminology as noted in our response to the main question 6 above, we disagree with some of the concepts and wording in the requirements.
- First, paragraph 48 refers to “assessing the likelihood and magnitude of material misstatement.” This is logically incorrect: one can assess the likelihood and magnitude of misstatement, or the likelihood of material misstatement, but not the likelihood and magnitude of material misstatement, because the threshold for needing to act as an auditor is when the magnitude is material. The only consideration of magnitude beyond materiality occurs when auditors consider whether misstatements are material and pervasive under ISA 705 (and perhaps when considering going concern issues) – but not as part of the assessment of inherent risk. Hence, the word “material” needs to be deleted. The same applies to the wording in application material in paragraph A221 und A222.
- Second, paragraph 48 (a) requires the auditor to take into account the degree to which identified events and conditions relating to significant classes of transactions, account balances and disclosures are subject to, or affected by, inherent risk factors. In our view, since inherent risk is

defined at assertion level, the consideration of inherent risk factors needs to be done by relevant assertion – not by significant classes of transactions, account balances and disclosures: the wording therefore needs to be changed accordingly.

- We also note that, based on our comments on main question 6 above, 48 (b) could be rationalized to read "... affect the assessment of inherent risks", for as noted, inherent risks are at assertion level. The same applies to paragraph 49, which should be rationalized to read "...assessment of inherent risks, any of these assessed risks are significant risks". Likewise, paragraph 50 should be changed to read "For identified inherent risks...", and 50 (a), (b) and 51 should be changed to read "... to respond to an inherent risk" not only for the reasons already noted, but also because controls respond to inherent risks, not "risks of material misstatement". The same applies to the related application material.

#### 16. Japanese Institute of Certified Public Accountants

We agree with the proposal to introduce the concept of spectrum of inherent risk, and the related concepts of assessing likelihood of occurrence and magnitude of a possible misstatement. However, we believe that it is necessary to clarify that assessment of inherent risk is divided into those due to fraud and those due to error, and the concept of spectrum of inherent risk is mainly used to show the degree of risk due to error (see our related comments on (e) below).

#### 17. Malaysian Institute of Accountants

We believe the introduction of the 'spectrum of inherent risk' will drive a more consistent and focused approach to help identify and assess risks of material misstatement, including significant risks. The introduction of the concepts of likelihood of occurrence and magnitude of a possible misstatement assist in assessing the risk of misstatement.

#### 18. Nederlandse Beroepsorganisatie van Accountants

The introduction of the 'spectrum of inherent risk' as such is fine, as it gives more refinement. However, the concept is not explained in detail. We feel that an illustration could help (e.g. the illustration as presented in the IAASB Board Meeting in June 2018 with the magnitude and likelihood presented in a diagram).

#### 19. National Board of Accountants (Tanzania)

We agree that the introduction of the 'spectrum of inherent risk' (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks.

#### 20. NZ Auditing and Assurance Standards Board

The NZAuASB supports the introduction of the concept and acknowledges the "spectrum of inherent risk" is a practical way to identify and then assess inherent risk. The NZAuASB also believes the concepts of likelihood of occurrence and magnitude of possible misstatements are useful, i.e. in planning the audit effort the auditor will take both of these into account. Feedback from NZAuASB's constituents indicates the proposed standard caters for different firm methodologies and will assist with the consistent application of ED-315 in practice.

**21. Altaf Noor Ali Chartered Accountants**

A6(c) Yes.

**22. BDO International**

Yes, we agree that the introduction of the 'spectrum of inherent risk' concept has the potential to achieve greater consistency in the identification of risks of material misstatements, including significant risks. In our view, introduction of the spectrum of inherent risk concept may result in improved auditor performance in the identification and assessment of risks of material misstatements, as it could lead to:

- More opportunity for engagement teams to think through the volume, mix and relative positioning of inherent risks and ultimately risks of material misstatement;
- Reinforcement of the notion that not all risks are the same and that there is a gradation of 'riskiness' leading to a range of risks, not all of which are deemed significant, which ultimately may lead to a more considered auditor response (which of itself, has to be in the public interest); and
- More informed discussions about risks and responses during Engagement Team Discussions.

We also support the inclusion of additional guidance for engagement teams in the areas of likelihood and magnitude. Emphasizing these concepts is helpful to teams and could lead to a more realistic assessment of inherent risks by auditors and engagement teams (i.e. those risks that are likely to occur and are quantitatively or qualitatively material to the financial statements). While we support the spectrum concept, there are however a number of matters that may not lead to improved consistency:

- By including the spectrum concept only in the Introductory (paragraph 5) and Application and Other Explanatory Materials (paragraph A222) sections, in our view this raises implicit reticence about the importance attached to this new concept by the IAASB. If the IAASB has sufficient confidence that this new change is likely to help achieve greater consistency, then from a public interest perspective we would have expected it to be included more prominently throughout (i) ISA 315 (Revised) in order to drive auditor behavior and (ii) conforming changes in other ISAs (220, 240) to help reinforce this concept. We believe that the requirements in ISA 315 should permit, but not require, a spectrum of inherent risk.
- Early IAASB board papers regarding development of the spectrum concept pointed to a matrix-style approach, however, the explanatory memorandum for ISA 315 (Revised) implies that inherent risks will be scored 'along' a spectrum – implying a more linear approach. In order to help firms focus on development of their training materials, tool or methodology changes, it might be helpful to provide further clarification to confirm one way or the other the Board's vision of how the spectrum is likely to operate. One way of doing this may be through a series of FAQs or other IFAC staff publications. If the likely outcome is that both models could apply, then providing this clarity would also be helpful to firms and auditors.
- Inevitably, there is a danger that the spectrum concept has the potential to introduce another layer of inconsistency into each audit. There is a risk that different people interpret magnitude and likelihood using different personal benchmarks or biases. Ultimately however, we take the view that it will be for firms to make a determination about how to put the spectrum of risk concept into practice. How firms apply this concept, including provision of ongoing training and monitoring its application, will determine how successful the introduction of this concept is likely to be. While the Explanatory Memorandum indicates that introduction of this concept should have no discernible impact on firms'

methodologies (and can be applied using a variety of methodologies), this may be an opportunity for some firms to reconsider their approaches to measuring and documenting the assessment of risks. For all of the above reasons, we believe this reinforces the need for the IAASB to provide a lengthy period of time between release of the revised standard and effective date.

#### 24. Crowe International

The inclusion of the “spectrum of inherent risk” is logical and helpful. This will help with the practical application of risk assessment concepts. It also helps reconcile the standards to “small, medium, high” language that is often used in proprietary audit solutions. However, IAASB should reflect on the practical implications of implementing the “spectrum” approach. Guidance ought to be developed to assist with the development of practical audit solution and to avoid the unintended consequence of crude solutions being developed that are too simplistic or shortcuts.

#### 25. Deloitte

DTTL is supportive of the concept of spectrum of inherent risk but believes that “spectrum of inherent risk” should be a defined term within the proposed standard. Currently, the proposed standard does not have the necessary clarity on what the spectrum of inherent risk should be based on. For example, it could be interpreted that the spectrum should be engagement-specific such that any risk that is on the higher end of the spectrum for that individual engagement would be a significant risk, which would result in auditors always having to identify significant risks. This interpretation would indicate that all audits are required to have significant risks, which is not currently a requirement within the ISAs. The definition of “spectrum of inherent risk” should therefore clarify that the spectrum is not meant to be audit engagement-specific but instead is a general scale to be used broadly. In addition, the Board should consider adding examples to the application guidance to support the consistent interpretation of the proposed standard in this regard.

#### 26. EY Global Limited

Yes, we believe that the ‘spectrum of inherent risk’ is a helpful concept in recognizing that ‘inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others’, and that the spectrum will assist auditors in making their assessments of inherent risk.

#### 27. Grant Thornton International

- We agree with the concept of a spectrum of inherent risk; however, we are of the view that the current proposals will not assist in achieving greater consistency in the identification and assessment of inherent risk and specifically those risks determined to be significant risks. Firms already identify different levels of risks in their methodologies through, for example, categorizations of low, elevated and high. Such methodologies do not typically require engagement team’s risk assessments to be plotted on a spectrum. It is unclear how the revised requirement and related application material is expected to change these categorizations or how the risks are assessed and included in these categories. Further, it is not clear whether the introduction of a spectrum of inherent risk is expected to affect sampling methodologies.
- Further, as noted in our response to Question 1 and further expanded on in our response to part e) of this question below, we do not agree that a risk can be determined to be significant based on its likelihood **or** its magnitude. If a risk of material misstatement has a high magnitude, but next to no chance of occurring, it does not seem appropriate to characterize this as a significant risk. It will also

likely result in increased variation in practice of the identification and assessment of the risks of material misstatement that are determined to be significant, rather than increased consistency. In our view, if the definition of significant risk is to be changed, it should be based on a combination of both its likelihood **and** its magnitude.

- Further, we are of the view that guidance is needed on how the spectrum of inherent risk will interact with the determination of Key Audit Matters (KAM). For example, could a risk that has been identified as reasonably possible but not be of a high magnitude result in a KAM being identified and communicated?

#### 28. KPMG IFRG Limited

- We are supportive of the introduction of the spectrum of inherent risk and we believe this aligns well with the other changes made in the ED to focus the auditor more specifically on consideration of “pure” inherent risk, and helps us to understand that this may vary continuously, rather than being the binary assessment of significant versus non-significant that we make at present.
- Together with the updated definition of significant risk, the concept of a spectrum helps the auditor to focus on the nature of the risks themselves, rather than requiring a determination as to whether a risk is significant based on the expected audit response, i.e. whether the risk requires “special audit consideration”.

#### 29. MNP LLP

Yes. We think that the introduction of “spectrum of inherent risk” will assist in achieving greater consistency in the identification and assessment of the risks of material misstatement. Please see our comments regarding significant risks below.

#### 30. PwC International

We support making explicit the concept of the spectrum of inherent risk, which is implicit in the extant standard. This is an important concept linked with the principle in ISA 330 that the higher the assessed risk the more persuasive the audit evidence needed. As a principle-based concept, firm methodologies will therefore continue to play an important role in how this is implemented in practice. We anticipate the existing approaches of firms will likely continue using terms, for example, such as low/medium/high. That is compatible with the concept, and the additional application material provided in the ED should prove useful in reinforcing understanding.

#### 31. RSM International

- The introduction of the concept of the ‘spectrum of inherent risk’ reflects the existing assessment of inherent risks where auditors often categorize these risks as high, medium or low.
- We question whether it will achieve greater consistency in the identification and assessment of risk, including significant risks, as many firms have a similar existing approach to identifying risks and therefore we doubt that it will really change behavior.

#### 32. Office of the Auditor-General of Alberta

- We note that the concept of “spectrum of risk” is too vague. We acknowledge that risk may be expressed qualitatively (low, medium, high) or quantitatively (10%, 20% etc.). Spectrum seems to



imply a continuous scale. Yet other definitions seem to imply otherwise; “relevant assertions” uses “reasonable possibility” as something more than remote, “significant risk” uses “close to the upper end of the spectrum” while 330.A42a may need to be revised because it uses “possible misstatement.”

- Our concern is that auditors may judge a risk to be remote because it is not “close to the upper end of the spectrum” or even a “reasonable possibility.” It is difficult to evaluate what a “reasonable possibility” is. Does it mean more likely than not? Does it mean that 19 out of 20 auditors would also arrive at the same assessment? Or does it just mean reasonable as “reasons have been documented for why this risk was assessed in that way.”
- The objective of consistency could have been achieved by simply stating that auditors typically are presumed to assess risk as low, medium and high. The concept of significant risks could be removed and instead the concept of “high risk” be used instead.

### 33. Office of the Auditor-General of Canada

No. In our view, the introduction of the “spectrum of inherent risk” will not result in consistency due to the extensive use of professional judgment in performing and concluding on risk assessment activities.

### 35. US Government Accountability Office

We support the introduction of the phrase spectrum of inherent risk and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement.

### 36. Swedish National Audit Office

- The introduction of the concept “**spectrum of inherent risk**” may to some extent assist in achieving greater consistency, though we question whether there is a need of introducing the use of the word “spectrum”. We understand this term refers to a scale of higher or lower risk of inherent risk. Less concepts would keep the standard clear, concise and easier to translate into other languages. We support the related concepts of magnitude and likelihood.
- According to paragraph A221 the inherent risk factors influence the auditor assessment of the likelihood and magnitude of misstatement for the identified risk of material misstatement at the assertion level. The assessment is supposed to be based on the inherent risk only, without considering the control risk (which could affect the assessment of likelihood). We suggest a further clarification that control risk should not be considered when assessing magnitude and likelihood, in paragraph A221.
- Paragraph A222 states that when considering the magnitude of the misstatement, the **quantitative** and **qualitative** aspects of the potential misstatement **may** be relevant. Our understanding is that these two aspects are the only aspects and the inclusion of “may” is to some extent confusing. If there are other aspects it needs to be addressed in the guidance. Further on it is not clear to us how to define qualitative aspects. Whether qualitative aspects only refer to non-financial information or if it should be interpreted broader (as for example account balances which may not be quantitatively material, but still considered as relevant for the users or related to factors as risk of fraud) is not clear.

- The revised ISA 315 uses the concepts of quantitatively vs. qualitative frequently and from different perspectives, for example the inherent risk factors and evaluation of the magnitude etc., but it never actually defines the meaning of “qualitative”.
- We also encourage IAASB to provide more examples and guidance on how to consider magnitude and likelihood as these will be the main drivers for assessing the risk of material misstatements, to ensure the intended purpose of ensuring greater consistency.

### 38. ACCA-CAANZ

- 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.

### 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

- We are generally supportive of the proposed changes, although we note that they are broad in nature and, if adopted, will likely impact the methodologies of many firms fairly significantly. Such changes often result in an iterative adoption process as the auditors become more familiar with the concepts over time. As such, we recommend that the IAASB consider some targeted outreach on certain of the changes (once ultimately adopted), such as those highlighted above. Notwithstanding our support for the changes, we have comments as follows:
- Paragraph 16(f) — Susceptibility to fraud is included as an inherent factor. We do not believe that susceptibility to fraud, intrinsically, is **inherent** in a characteristic of events or conditions. ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, defines fraud, as follows:

An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception that results in a misstatement in financial statements that are the subject of an audit.

- Fraud is characterized by the following factors defined in ISA 240:

Events or conditions that indicate an incentive or pressure to perpetrate fraud, provide an opportunity to commit fraud, or indicate attitudes or rationalizations to justify a fraudulent action.

- Given the definition of fraud and the related risk factors, we do not believe that susceptibility to fraud should be characterized as an inherent risk factor. If the IAASB determines it is important to specifically cite inherent risk factors related to fraud, we recommend the standard focus on incentives or pressures to commit fraud, accompanied by the inclusion of references to ISA 240 as appropriate.
- 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.
- Paragraphs 48 and 50 — To further highlight the importance of the focus on, and definition of, relevant assertions, we recommend the standard emphasize that the assessments called for by these paragraphs (and the corresponding response in ISA 330, *The Auditor's Responses to Assessed*) are to be performed for each relevant assertion. We understand that the IAASB’s intent is for the auditor to design the work effort to the level at which assertions are relevant, and we believe emphasis of that point in these paragraphs will enhance the auditor’s focus on those assertions.

#### 42. Chartered Institute of Public Finance & Accountancy

CIPFA is content with the concept of spectrum of risk. Even in approaches which take a discrete (e.g. high, medium, low) approach, there is an implicit spectrum, and care has to be taken where judgements are at the top and bottom ends of risk categories.

#### 43. CPA Australia

The spectrum of risk is useful in understanding the impact of the magnitude and likelihood of material misstatement arising from the identified risks, however it does not necessarily help to identify the cut-off for significant risks, albeit that this may be a matter of professional judgement.

#### 44. EFAA

While we welcome the concept of 'spectrum of inherent risk' we believe understandability will be improved via the inclusion of an illustrative figure.

#### 45. Finnish Association of Authorised Public Accountants

The term spectrum is difficult to translate into Finnish, and probably many other languages (see question 11). It is also not clear how the likelihood and magnitude affect the positioning of inherent risk on the spectrum and how this affects the amount of further audit procedures (see also 6a).

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

Absolutely agree. The use of this concept will help eliminate the potential oversizing of inherent risks.

#### 47. FSR Danske Revisorer (Denmark)

In our opinion it should be made more clear how the auditor should, as part of his/her risk assessment, assess how the different risks of significant misstatements are placed on the risk continuum to make sure that an appropriate audit response can be designed.

#### 48. Interamerican accounting association (South America)

Yes, we understand that it will positively help that purpose. Having a clear view of the inherent risk and considering the possible occurrence of a misstatement of significant magnitude will help the auditor to achieve greater connection between the two interdependent elements, identifying and evaluating the risks of material errors.

#### 49. Instituto dos Auditores Independentes do Brazil

Using a spectrum of inherent risk will lead to risk assessments that better identify the reasons underlying inherent risk and enable auditors to design their responses more appropriately. It could lead to an improved outcome as it is more likely to reflect the reality of the entity aligned with the determination of RMM or SRMM.

#### 51. Institute of Chartered Accountants in England and Wales

- To an extent, the introduction of the concept of the 'spectrum of inherent risk' reflects and codifies what actually happens in an inherent risk identification and assessment exercise. This of itself is beneficial and the codification represents an improvement on the extant ISA. However, we doubt that

it will achieve greater consistency in the identification and assessment of risk, including significant risks.

- We note in our response to Q1 above, that many firms believe that they already have a spectrum of risk in place in the form of discrete classifications of risk as high, medium or low, or significant, normal (i.e. material) and no risk, for example. While on the face of it the new concept seems sensible, many firms will justify their existing approach with reference to it and as a result, there may be little change in behavior, no reduction in inconsistent risk assessments and no improved risk assessments. This is a public interest issue. Auditors and audit regulators will need to engage in a more meaningful discussion regarding the application of judgement in this area. Inconsistencies in existing approaches, compounded by novel approaches to the proposed requirements, may actually increase inconsistencies in the eyes of audit regulators who should also be aware that a different set of significant risks may be identified using the new definition. In particular, some risks currently caught may not meet the revised definition, depending on how the proposals are interpreted.
- If IAASB wishes to improve practice in this area it needs to better articulate, or provide examples of, how auditors might weigh the inherent risk factors when assessing the many risks that fall into the highly populated 'grey' area in the middle of the spectrum. One way of achieving this might be to provide examples of contrasting situations in which an apparently similar risk might be assessed as being at the lower, middle and upper ends of the spectrum, depending on specified circumstances. While the response to the risk assessment is outside the scope of this revision, we believe that considering the response in such contrasting situations would provide useful insights.

#### 52. Institute of Chartered Accountants (Ghana)

Yes, the introduction of the spectrum of inherent risk will assist the auditor in achieving greater consistency in the identification and assessment of the risks of material misstatement. The risk to which inherent risk varies is referred to as spectrum of inherent risk. The introduction of the spectrum will assist the audit in achieving greater consistency in the identification and assessment of the risks of material misstatement. There is now a common framework that practitioners will use to assess inherent risk. This can only help ensure consistency in practice.

#### 53. Institute of Chartered Accountants of Pakistan

This concept is already introduced in ISA 540 (revised) and consistent with the way it is described in ED 315. Primarily we agree with the introduction of the term 'spectrum of inherent risk' and its linkage with the inherent risk factors. We understand that is a subjective term and should be further supported /explained with appropriate examples.

#### 54. Institute of Chartered Accountants of Scotland

We do not consider the inclusion of the concept of a spectrum of inherent risk helpful in facilitating and identifying the level of inherent risk. The determination of the level of inherent risk may be less problematic for smaller and less complex entities, than for listed entities where greater judgement will be necessary in determining exactly where they should sit on such a spectrum, and therefore further clarification and explanation of this concept and its application is required.

**55. Institute of Chartered Accountants (Zimbabwe)**

Yes. The new proposal provides guidance on how the degree to which inherent risk varies, creating a framework for auditors to refer to at any point in time.

**57. Institute of Public Accountants**

- Risk spectrum – The IPA has deep concern with the introduction of risk spectrum approach. The IPA is of the view that auditors already display a propensity to underestimate risk and that this would be exacerbated by a spectrum approach to risk. The IPA also believes that a risk spectrum approach is inappropriate in an audit context as a risk spectrum implies a granular response to risk mitigation (e.g. increased risk capital allocated to increasing credit risk) that is not demonstrated in the audit response to risk which is a “step” approach. As such, the IPA recommends that the standard recognize that three or four discrete risk grades (e.g. High, Moderate, Low) may result from the risk assessment process rather than use the term “risk spectrum”.
- 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.

**59. Malaysian Institute of CPAs**

Introduction of any new term will invariably require some time for auditors to be familiar with and apply, hence time will tell if the introduction of the “spectrum of inherent risk” (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) will assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks.

**61. PAFA**

It is PAFA's view that the introduction of 'spectrum of inherent risk' (and related concepts of assessing the likelihood of occurrence and magnitude, of a possible misstatement) will assist in achieving greater consistency in the identification and assessment of risks of material misstatements, including significant risks.

**62. SAICA**

- SAICA believes that the concept of a spectrum of inherent risk explains current practice and supports its inclusion. In particular, our view is that it may positively influence auditor behavior in terms of an improved understanding that the level of persuasive evidence that is required also varies along this spectrum. Furthermore, it will address a concern that has been raised in some instances that auditors, under extant ISA 315, simply distinguished between risks that are significant and risks that are not significant, resulting in the latter not always receiving appropriate attention in terms of the level of audit evidence that is required, depending on where on the spectrum the inherent risk exists.
- In our view, the introduction of the 'spectrum of inherent risk' reflects what already happens in practice. We support the IAASB's retention of, and requirement to, determine significant risks.

- However, we are not convinced the introduction of the spectrum will assist in achieving greater consistency in the identification and assessment of risk, including significant risks. There is a concern that the requirements do not deal with the spectrum very thoroughly and so it is not clear what is required of auditors. The definitions mention “high end of the spectrum”, but it may not be easy to determine exactly where a threshold lies. All stakeholders (auditors, audit inspectors, professional accountancy organizations) will need to engage in substantial discussions regarding the application of professional judgement in this area.

#### 65. Chartered Accountants Academy (Zimbabwe)

We believe the introduction of the spectrum of inherent risk will assist in achieve greater consistency in identification and assessment of risks of material misstatement. The new proposal provides guidance on how the degree to which inherent risk varies, creating a framework for auditors to refer to at any point in time.

#### 66. FocusRoi Inc.

Yes, especially when a numeric scale such as 1-5 is used to assess likelihood of occurrence and magnitude rather than the simple high medium and low. Some discussion of how to use numeric evaluations would be helpful in the application material

#### 67. Lynessa Dias

- The standard calls for a tabulation of the susceptibility to risks at the assertion level in a class of transactions, account balances and disclosures on the spectrum of inherent risk. This would require a quantitative evaluation of risk on subjectively defined business processes. The revised standard suggests numerical categorizations (scale of one to ten) or relative classifications (high, medium, low) based on likelihood of magnitude and frequency. In addition, for greater consistency of approach in the application of the spectrum of inherent risk, business process risks at the assertion level should take into account past incidents, fraud occurrences within the industry and within specific business processes.
- Complexity of business process should be defined by factors such as the number of persons involved in the business process, degree of automation and computer programming, the individual transaction value, the number of transactions etc. These attributes should be quantified, as a proportion of the size of the entity, in order to effectively reach a risk measure on the inherent risk spectrum. Measuring the gross effect on the class of transactions, account balances and disclosures through a broader range of common factors would then be a numerical exercise that is more objectively determinable. Additionally, multi-variable risk evaluation of business processes would help with the scalability issue as business processes would be assessed within the size and scope of the entity's operations.
- Alternatively, risk of material misstatement could be assessed based on the materiality of financial statement disclosures. Material balances could be evaluated for their susceptibility to inherent business process risks and risks pertaining to effectiveness of existing controls. This would be a more efficient top-down format to evaluate risks based on their impact to material financial statement balances. In addition, relevant assertions are general in nature and impact all account classes, balances and disclosures. So narrowing down the scope to high value and significant financial statement KPIs that are material and can effectively influence the behavior of a market participant, would make the audit process more effective.

