

Responses to ED-315¹
Comments on 'Understanding the Entity's System of Internal Control'
NVivo Report 3A
(FOR REFERENCE)

01. BCBS

In general, the proposals seem clear in addressing all components of the system of internal control, the link between the understanding obtained and the risk assessment process and the requirements for auditors.

We would like to emphasize the importance of understanding applicable laws and regulations. While it is mentioned that compliance is a part of the system of internal control, the definition of compliance with laws and regulations does not seem to expressly cover or include compliance **with prudential regulations**, which for banks is a priority. Our suggestion would be to expand the definition and therefore include the understanding of applicable prudential laws and regulations in the risk assessment phase.

02. CEAOB

Paragraphs 29 and 35 require an auditor to "obtain an understanding" of various components "by understanding (...)" – we believe further clarity is required to set an expectation for the auditors' work under those paragraphs. We recommend removing the second reference to 'understanding' and better describing the actions to be taken by the auditor to obtain the necessary understanding.

07. IOSCO

Reference 1:

Controls

We note that paragraph 26 of the Paper indicates that "the auditor shall identify controls relevant to the audit, and shall evaluate the design of such controls and determine whether the controls have been implemented in accordance with the requirements set out in paragraphs 39 to 42." In other paragraphs of the Paper, the auditor's requirements are described in the context of obtaining an understanding. For example, paragraph 17(c) indicates that the auditor shall design and perform risk assessment procedures to obtain an understanding of the entity's system of internal control in accordance with paragraphs 25-44 and other paragraphs also use "obtain an understanding" as the construct compared to evaluate the design of the controls. We are concerned that these inconsistencies in the description of auditor requirements may result in confusion and diversity in practices regarding the consideration of the entity's system of internal controls and whether understanding of internal controls includes evaluating the design of the controls and whether they are implemented.

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

Reference 2:

- We also noted a few instances, for example paragraph 29 regarding the entity's risks assessment process and paragraph 35 regarding the information system and communication, where the Paper states that the auditor "shall obtain an understanding" either by or through "understanding." It is not clear to us what the expectations of the auditor are in these areas and what the corresponding level of audit evidence obtained should be.
- Auditors often identify and test higher level and entity level controls, such as the comparison of monthly results of operations to forecasted amounts or prior period amounts. We believe the Board should proactively address the potential for over-reliance on controls of this nature and provide guidance specific to the role of these types of controls in the audit.
- Paragraph 16(d) defines controls as "policies or procedures that are embedded within the components of the system of internal control to achieve the control objectives of management or those charged with governance." It is indicated that policies may be "implied through actions or decisions" and that procedures are actions to implement policies. We are concerned that this imposes a responsibility on the auditor to understand the population of controls beyond what the company has documented, which may not be feasible or appropriate.
- Further, as paragraph 16 provides definitions of "controls" and two such types of controls including "general information technology (IT) controls" and "application controls," we believe the Board should expand the definition of "controls" to include notation of a comprehensive list of types of controls in order to prevent confusion or give the appearance the defined terms are the only types of controls that are relevant to the risk assessment process.

08. IRBA

Reference 1:

The proposals made relating to the auditor's understanding of the entity's system of internal control do assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks or material misstatement.

Reference 2:

Yes, the requirements related to the auditor's understanding of each component of the entity's system of internal control have been appropriately enhanced and clarified.

- ED-315 is clear as to why the understanding is obtained and how this informs the risk identification and assessment process. The flowcharts are also helpful in this regard.
- We suggest that the IAASB expand on the requirements for the control activities component to be in line with the other components of the entity's system of internal control in ED-315 with respect to presentation and structure.

09. UK Financial Reporting Council

We support the enhancements to the requirements and application material related to the auditor's understanding of each component of the system of internal control and believe they have been appropriately enhanced and clarified. We agree with the IAASB's enhancements that clarify:

- That the scope of the auditor's understanding of internal control is of *all* components of the entity's system of internal control relevant to financial reporting.
- The nature of each component, such that three components consist primarily of 'indirect controls' and two components consist of primarily 'direct controls', and the updated terms used to describe aspects of the entity's system of internal control (as explained in paragraph 33 of the explanatory memorandum).
- Specific matters relating to each component that need to be understood.

11. Australian A&A Standards Board

The AUASB considers that ED 315 provides greater clarity in relation to what is required when obtaining an understanding of each component of the entity's system of internal control and how this informs the risk identification and assessment process. Additionally, the flowcharts and the updated definitions provide greater clarity. However, in the AUASB's view the following needs to be clarified:

- The impact of the understanding of an entity's system of internal control and how this is applied in identifying and assessing the risks of material misstatement, including control risk:
 - The understanding of the entity's system of internal control is used when identifying risks of material misstatement, however paragraph 4 states that this is done before consideration of any controls. We consider this wording is confusing and needs to explicitly state that the identification of risk at this point is based on inherent risk only and does not take into account the planned reliance on controls. Refer to question 6(a).
 - The understanding of the entity's system of internal control provides a basis for the determination of the extent to which the auditor plans to rely on the operating effectiveness of controls. The assessment of control risk is based on the planned reliance on the operating effectiveness of controls.
- More guidance on which controls reside in the Information System and Communication component as distinct from the Control Activities component, and the difference, if any, on the requirements in relation to the audit procedures to be performed on these controls.
- Paragraph 35 requires an understanding of the information system relevant to financial reporting, and paragraph 36 requires the design and implementation testing of these controls. It is not clear how to obtain this understanding, and whether paragraph 35 and 36 can be performed in conjunction with each other. We would suggest that these two paragraphs be revised to ensure greater granularity of the two requirements.
- Amend paragraph 35 (a) (ii) to read "Information about significant events and conditions..."

12. Canadian AASB

Reference 1:

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

- *Understanding versus evaluating the design of components of internal control* - It's not clear how the auditor evaluates the control components "Control Environment" and "The Entity's Risk Assessment Process". The requirements and application material to these components indicate the auditor may identify control deficiencies. However, other application material indicates these are indirect components where the auditor may not identify controls relevant to the audit and therefore may not perform design and implementation procedures. We suggest the term "assess" be used in place of "evaluate" in these circumstances. [Please see our response to Q5a for further details].
- *Lack of clarity in the "information system and communication" component of internal control (paragraphs 35-36)* – in particular the extent of understanding required; the controls the auditor would identify and how these controls would differ from those identified under the requirement to perform design and implementation procedures over controls relevant to the audit (paragraph 42); and the impact on the audit when the methods and controls used by the entity to generate information are weak. [Please see our response to Q5c for further details].

Reference 2:

- While we agree ED-315 enhanced the requirements related to the auditor's understanding of each component of internal control, we believe there are items that should be clarified. Key areas where field testing participants expressed different interpretations are detailed below. We suggest all comments accepted by the IAASB should also be reflected in the flow charts in the final standard.

Lack of clarity on whether inquiry alone is sufficient to understand indirect components

- Paragraph A20 indicates that the auditor need not perform all the risk assessment procedures for each aspect of the understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control. Some participants of the field testing thought inquiry alone would be sufficient for the understanding of the components of internal control while others thought more was needed.
- The ISA 315 Task Force Chair indicated in the IAASB's Q&A webinar on October 3, 2018 that inquiry alone was not sufficient because of the guidance in ISA 500.A2. However, that guidance refers specifically to "inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level...", which could be interpreted as only relating to the audit procedures that are designed to respond to the assessed risk.
- We encourage the IAASB to provide clarity on whether observation and inspection is expected to be performed when obtaining an understanding of the indirect components of internal control (control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control).

Understanding, versus evaluating the design of, components of internal control

- We support the separation between “understanding each of the components” of internal control in paragraph 25 from “identifying controls relevant to the audit and evaluating the design and implementation of those relevant controls” in paragraph 26. This separation addresses a key concern with the extant standard that when some auditors use their professional judgment to decide that there are no controls relevant to their audit, they do not understand any of the components of internal control.
- However, we believe the reference to “evaluation” within the auditor’s understanding of certain of the components of internal control (paragraphs 28 and 31) is not clear and could be confused with the auditor’s “evaluation of the design of relevant controls”. For example, application material in paragraph A100 and A104 suggests the first three components are considered indirect components and that the auditor would typically not identify controls relevant to the audit from those components. However, paragraphs 28 and 31 require an evaluation based on whether there are control deficiencies identified. Paragraphs A111, A121, A218, and A219 all refer to control deficiencies within the first two components of internal control, but we believe the auditor must perform design and implementation procedures to identify a deficiency. If the IAASB’s intention was not to require the auditor to perform design and implementation procedures within these components, we suggest another term such as “assess” be used in place of “evaluate”.
- While we agree that the auditor should assess the appropriateness of these components (an edit suggested in the paragraph above to paragraphs 28(b) and 31(a)), we believe the auditor can conclude that the control environment is inappropriate without having to identify individual controls within these components and evaluating control deficiencies. Therefore, we suggest the IAASB consider replacing the references to “control deficiencies” in paragraph 28(b) and 31(b) with “inappropriate foundation for other components of internal control”. The application material in paragraphs A111 and A219 provides useful information on the next steps the auditor may follow if the control environment is found to be inappropriate or if the environment raises doubts about the auditability of the financial statements.

Inconsistent reference to the “formality” of components of internal control

- Paragraphs 29 and 32 require the auditor to obtain an understanding of the entity’s risk assessment process and the entity’s process to monitor the system of internal controls, “including the extent to which it is formalized”. Paragraph 31(a) uses a different term “including its formality”. It is unclear how the auditor evaluates “formality”. Without the text “the extent to which” in paragraph 31(a), it could be interpreted as a binary decision of formal or not formal. We suggest updating paragraph 31(a) to refer to “including the extent to which it is formalized” to be consistent with the requirements in paragraphs 29 and 32.

Lack of clarity on the type of risk resulting from an entity’s inappropriate risk assessment process

- When the control environment is found to be ineffective, paragraph A111 guides the auditor to say this could lead to a financial statement level risk. We believe there should be a similar statement in the application material relating to the entity’s risk assessment process (in paragraph A121) that the lack of an appropriate risk assessment process may lead to a financial statement level risk.

Reference to significant classes of transactions, account balances and disclosures in paragraph 35(a) is circular

- Many participants of the field testing were confused by paragraph 35(a) and did not realize that it is intended to assist the auditor in making an “educated guess” or a preliminary assessment of inherent risk based on a reasonable possibility of material misstatement. After discussing the graphic included on page 20 of the explanatory memorandum which references a “preliminary assessment of inherent risk” and making an “educated guess”, and paragraph A141 which contains useful information to explain the linkage between paragraphs 23, 35 and 46, practitioners supported this “educated guess” concept and agreed that the concept is used in practice today. However, this concept was not clear in paragraph 35(a).
- Paragraph 23 refers to “understanding the classes of transactions, account balances, and disclosures to be expected in the financial statements.”. We suggest the IAASB consider using language in paragraph 23 that is similar to the lead in to paragraph 35(a) (suggested edits showing in underline and strikethrough):

“The auditor shall obtain an understanding of the information system relevant to financial reporting, including the related business processes, through understanding how information related to ~~significant~~ classes of transactions, account balance, and disclosures that are expected to be significant to the financial statements flow through...”.

13. CNCC-CSOEC

We agree that auditor’s understanding of each component of the entity’s system of internal control is a prerequisite of assessing control risk during the risk identification and assessment process.

14. Hong Kong Institute of CPAs

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

15. IDW

- Our consideration of paragraphs 25 to 44 and the related application material indicates that the requirements related to the auditor’s understanding of each component of the entity’s system of internal control has been largely clarified. However, whether these have been appropriately enhanced is another issue. We agree with many of the changes and additions. However, we strongly disagree with the change relating to obtaining an understanding of the information system and communication.

- Due to the definition of “significant classes of transactions, account balances and disclosures” in paragraph 16 (j), which means these are significant if there is at least one relevant assertion, and the definition of “relevant assertion”, which essentially defines a relevant assertion as one in which the likelihood of material misstatement is *more than remote* (a very low threshold), the draft dramatically broadens the scope of those classes of transactions that are significant for purposes of paragraph 35 (a), compared to the classes of transactions that (together with the definition of “significance” in the IAASB Glossary) would have been construed as significant for the purposes of paragraph 18(a) in extant ISA 315. This dramatic broadening will lead to almost no classes of transactions, account balances and disclosures being regarded as not significant for the purposes of paragraph 35 (a) in the draft. This broadening also implies a very large increase in work effort for obtaining an understanding of the information system. Furthermore, such broadening would also involve a significant increase in work effort for the evaluation of the design of the information system controls relevant to financial reporting as required by paragraph 36 of the draft.
- It is clear to us that obtaining an understanding of the information system can be an important source of information to enable the identification of both risks of material misstatement at the financial statement level and inherent risks (which are defined as being at the assertion level). We also recognize that such an understanding also provides information to enable the assessment of those risks and the assessment of control risks (also defined at the assertion level). To this effect, we disagree with the statement in the question that such understanding “informs” the “risk identification and assessment *process*”: it provides information that is used to help identify and assess the noted risks. However, from a public interest perspective, we are not convinced that lowering the threshold of significance in this way with the concomitant large increase in work effort will lead to an increase in assurance that is worth the resulting increase in work effort. We refer to our proposal in our response to (d) below, in which we suggest a more reasonable threshold for a relevant assertion that would also make the standard more scalable for audits of financial statements of smaller and less complex entities.

Other relevant extracts:

We have difficulty translating the use of the term “less formal” or less “formalized” in relation to the risk assessment process in paragraphs 29 and 31 (a) and in relation to the system of internal control in paragraph 32, as well as in the related application material paragraphs.

We found the reference to “less structured and simpler” as used, for example, in paragraph A93 to be more understandable and easier to translate and ask ourselves whether this description could be used instead of “formal” and “formalized”.

16. Japanese Institute of Certified Public Accountants

- We support that ED-315 requires the auditor to obtain an understanding of five components of the entity’s system of internal control. We also support classifying the components of internal control as “indirect controls” and “direct controls” based on the nature of components, as it would clarify the relationship between understanding the entity’s system of internal control and the work effort of identifying and assessing the risks of material misstatement. Given the length of ED-315 and its complexity, we believe the flowcharts and additional supporting tools are essential to enhance the understandability of the standard.

- Notwithstanding our overall support, we are concerned that:

Audit procedures to obtain an understanding of the indirect controls

- It would enhance the understandability and practicality of application of the standard if ED-315 provided clearer descriptions as to what audit procedures are to be performed in order to obtain an understanding and evaluation of the control environment, the entity's risk assessment process and the entity's process to monitor the system of internal control. Paragraph A20 states that "although the auditor is required to perform all the risk assessment procedures described in paragraph 18 in the course of obtaining the required understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control (see paragraphs 23–44), the auditor is not required to perform all of them for each aspect of that understanding."
- Additionally, paragraph A198 indicates that "risk assessment procedures to obtain audit evidence about the design and implementation of controls relevant to the audit" include inquiry and other risk assessment procedures. On the other hand, the second sentence in paragraph A108 explains that "the nature, timing and extent of the auditor's procedure to obtain the understanding of the control environment may vary to the extent necessary," which is followed by the third sentence which introduces an example where the auditor performs inquiry as well as observation and inspection. With regard to these paragraphs, it is not clear whether there could be a situation where the inquiry alone can be sufficient as one of the effective risk assessment procedures.

17. Malaysian Institute of Accountants

The requirements related to the auditor's understanding of each component of the entity's system of internal control are clear, including the reason for the required understanding and how it informs the risk identification and assessment process.

18. Nederlandse Beroepsorganisatie van Accountants

- It is not clear why the auditor should understand each component of the entity's system of internal control if the auditor will not rely on the system of internal control and will set the control risk at the maximum. We recommend to make clear that the system of internal control remains important to consider, even when a substantive audit approach is adopted. There are risks for which substantive procedures alone are not sufficient. An understanding of the system of internal control will help to understand the entity, perform an appropriate risk identification and assessment process and design an appropriate audit approach.
- In our opinion more attention should be given to culture and behavior (also sometimes referred to as 'soft controls'). Although culture and behavior are mentioned (e.g. tone at the top is mentioned in the explanatory memorandum, but not in the ED itself), we feel that this could be elaborated more in the ED. In the new COSO ERM model more attention is paid to governance and culture as well. In recent business and audit failures, the deficiencies in 'soft controls' played an important part.
- In line with COSO the system of internal control exists of 5 components who together can ensure that an entity is in control. Within all these components an entity can design and implement controls.

According to the flowchart 'Obtaining an understanding of the Entity's System of Internal Control – ISA 315 (Revised) Para 25-44 the evaluation of the first three components (Control environment, risk assessment and monitoring controls) can lead to the identification of risks of material misstatement at the financial statement level. The controls within the last two (information system & communication and control activities) can lead to lower levels of control risk for relevant controls when effectiveness of the controls is proven.

- The flowchart suggests that the evaluation of the first three components can only lead to the identification of risk and that it does not lower (control) risk / risk of material misstatement. Although we acknowledge that testing of the effectiveness of indirect controls is challenging it seems not realistic to deny that tone at the top, culture etc. influence the risk of material misstatement. At the same time assuming effectiveness without testing is inconsistent with the standards statement that control risk is maximal when effectiveness is not proven through testing.
- We wonder whether the standard sufficiently recognizes the way in which entities organize their system of internal control and thus manage being in control. We are convinced that the control environment influences the likelihood of risks occurring and thus we feel that indirect controls in this area, although difficult to test, diminish the risk of material misstatement. We urge the IAASB to further investigate how these indirect controls can contribute without fully testing them. Although this seems new territory we take a similar approach during the risk assessment. Based on risk assessment procedures we determine inherent risks and relevant assertions. In reality we decide which assertions are not relevant. If we did not perform risk assessment procedures all assertions would be relevant.

19. National Board of Accountants Tanzania

The requirements related to the auditor's understanding of each component of the entity's system of internal control have been appropriately enhanced and clarified and it is also clear why the understanding is obtained and how this informs the risk identification and assessment process.

20. NZ Auditing and Assurance Standards Board

- The NZAuASB agrees that obtaining an understanding of the system of internal controls is a fundamental part of the auditor's risk assessment. Paragraph A200 of ED-315 provides a reasonable explanation why understanding the system of internal controls is required in an audit even if there is no expectation of testing the operating effectiveness of controls (i.e. control risk defaulted to maximum).
- Notwithstanding the above, during the NZAuASB's consultations with its constituency, a recurring question was why understanding all the components of the entity's system of internal control (to the extent required by ED-315) is required when a primarily substantive approach to the audit is planned. For example, when an auditor does not rely on internal controls (control risk defaulted to a maximum), the outcome of such an understanding will have no impact on the auditor's assessment of internal control (risk of internal controls cannot be more than maximum).
- The NZAuASB believes that it may be helpful to further clarify that understanding the system of internal control is relevant to the auditor's identification and assessment of inherent risk as well as control risk. The NZAuASB supports non-authoritative guidance including examples to clarify this

issue. The IAASB webinar dealing with questions and answers were extremely helpful in this regard, and it may be worthwhile publishing a FAQ to assist auditors with the implementation of the standard.

21. Altaf Noor Ali Chartered Accountants

Reference 1:

- Management of the entities are free to have the kind of internal control system suitable to their needs. They may decide even not to have one. Why? There is no obligation on anybody to have one. In my part of the world, and perhaps others, management are more conscious about the cost than the intangible unidentified immeasurable benefit of having a suitable system of internal control, most have none and are not even conscious about it. Audit, for most, is just a formality. They know auditor is bound to an opinion on the financial statements. Why bother about a term that is not even mentioned in the entire audit report?
- A system of internal control is central to the conduct of an audit. If true, make it a point of audit report. We wish there was a provision in the audit report about the most important matter which significantly affects the work of an auditor: internal control. "During the course of audit, we have reviewed the system of internal control and have rated its overall effectiveness as Satisfactory/Good/Fair/Non-existent and/or unreliable. We have/have not noted any improvements from the last audit. A system of internal control is....." Is there any other way of making management more sensitive about it?
- Small and medium sized practices mostly serve smaller entities and face the reality of owner-manager or dominant individual every day in most audits. If a client do not have a system of internal control because they are not sophisticated enough to understand its importance or for any other reason, what can an auditor do? It's not the same to do go through every transaction, even which will not suffice.
- It is global that our clients face difficult operating and business environment which compels them to keep the costs at minimum and enhance productivity. One or two-person accounting department or totally outsourced accounting services are facts; these same forces mirror in public practices which suffer from anemic audit fee growth; only single staff is assigned with a stiff deadline to do everything, unlike an audit team in the past. So what kind of internal control can one expect? Technology is live and kicking threatening to wipe out the position of full-time accountants. In short, cost pressures do not permit the clients to improve system of internal control. On the other hand, auditors do not have yardsticks to measure the same or the means to report on them.
- One way of making the ED-315 more relevant is to provide more guidance on what needs to be done on the first and recurring audits. This is as important as it is for complex and not-so-complex entities.
- The standard setters understand that the requirements for the complex audits may not be relevant to the not-so-complex entities. If true, why not we reflect it in ED-315? The practitioners are on a lookout for relevant exclusive guidance. An area of overlap is understandable but not the present regime of having buffet-standards audit mindset. I give credit to International Accounting Standards Board for liberating itself from those shackles and coming up with a stand-alone version of IFRS for SMEs.
- We do wish ISAs to split metaphorically on the same pattern with size and complexity reigning. We see it as two lanes of the same road. It helps to have proper signage to be guided to the destination!

- To conclude, the proposals here do not assist with understanding the nature and extent of the work effort required; the ISAs contain statement of principles than prescription. Most smaller entities do not have proper system of internal control because of cost/benefit, technology and economic compulsions. Times are changing and auditors of smaller entities will find it even difficult to give a fair opinion based solely on substantive testing.

Reference 2:

No. We are not sure how auditor would conclude the understanding of the matters mentioned in para 27. It lacks guidance on what to do if the internal control system is not there. It calls to 'demonstrate' a term that we find to be quite subjective. Appendix 1 helps but leaves one without much confidence.

22. BDO International

- We believe that the requirements relating to the auditor's understanding of the following components of the entity's system of internal control have been appropriately enhanced and clarified:
 - Control environment
 - Entity's risk assessment process
 - Entity's process to monitor the system of internal control
 - Control activities
 - The communication part of the component on the information system and communication.
- Regarding control activities, we agree with the requirement in paragraph 38 that limits the auditor's understanding of control activities to just those controls that are relevant to the audit within the control activities component.
- However, we have concerns regarding the information system component of internal control, as described in the following paragraphs.

Design and implementation of information system controls relevant to financial reporting

- Our understanding of the proposals in ED-315 is that the auditor needs to obtain an understanding of the entity's system of internal control relevant to financial reporting (paragraph 25), and then assess design and implementation of only those controls deemed relevant to the audit (paragraph 26).
- However, a number of paragraphs in ED-315 add confusion because they seem to require the auditor to obtain an understanding of the 'information system relevant to financial reporting, including the related business processes' (paragraph 35), as well as to evaluate the design and implementation (D&I) of those 'information system controls relevant to financial reporting' (paragraph 36). Related application paragraph A152, which defines 'information system controls relevant to financial reporting', talks about policies and procedures in the entity's financial reporting processes, but does not clarify that they only include controls relevant to the audit. Paragraph A156 refers to evaluating 'the design of the information system and determine whether it has been implemented' without referring to controls at all, which further adds to the confusion. Finally, paragraph A157 implies that 'information system controls relevant to financial reporting' are different than 'controls over the information system [which] are treated as controls in the control activities component and may be

identified as controls relevant to the audit'. Therefore, it is not clear whether paragraph 36 is requiring an assessment of D&I of only controls in the information system that are relevant to the audit, or whether the auditor is required to assess D&I of the related business processes in the information system too. Evaluating the D&I of related business processes goes beyond the general principle in paragraph 26 of only assessing D&I of controls relevant to the audit. We are concerned that the confusion between paragraphs 26 and 36 will cause inconsistent application in practice.

- Furthermore, it is not clear if the auditor is required to assess the design and implementation of all information system controls relevant to financial reporting, or only those that are also determined to be relevant to the audit (as determined by paragraph 39). We believe it should be the latter.
- We believe that for the information systems component of internal control, auditors should still only assess D&I for controls relevant to the audit that are identified in that component. We believe this needs to be made clearer in paragraphs 36, A152, A154, A156 and A157.
- Finally, if the expectations on the work effort required to assess controls are the same in paragraphs 26 and 36, we recommend that the related application guidance paragraphs A153 and A198 use consistent wording. It is very difficult to determine the practical difference when applying these two application guidance paragraphs. Alternatively, one of the application guidance paragraphs could be removed and referenced from both requirement paragraphs.

24. Crowe International

Reference 1:

The section on the auditor's understanding of the entity's system of internal control appears to be much improved.

Reference 2:

The requirements are clear and are effectively supported by the paragraphs that explain how auditors use the information obtained about the five components in the risk assessment process.

25. Deloitte

DTTL is supportive of the enhanced requirements and related guidance on obtaining an understanding of the entity's system of internal control to inform the risk identification and assessment process. DTTL believes that obtaining an understanding of the entity's system of internal control, including the IT environment, is essential to the risk assessment process due to the significant use of technology by entities. DTTL believes that the proposed standard outlines why the understanding of an entity's system of internal control is obtained and how the auditor's understanding of the entity's system of internal control informs the risk identification and assessment process. In addition, as stated in response to **question 2** above, DTTL believes that additional non-authoritative guidance is needed to support smaller and less complex entities. Due to the changes in the proposed standard on understanding of the entity's system of internal control, DTTL believes that this area should be included in any non-authoritative guidance developed by the IAASB for smaller and less complex entities.

26. EY Global Limited

Reference 1:

We believe that pointing out that controls in smaller and less complex entities may be less formal and may be not documented by the entity is useful guidance for the auditors of these entities because this reflects the nature of internal control in many small entities. The auditor's understanding of the system of internal control for these small entities often involves understanding procedures, formal or informal, that management uses in their day-to-day involvement in the financial aspects of the business and how management influences or participates in activities and transactions.

Reference 2:

Yes, with two exceptions.

- Control environment

We are concerned that the requirement in paragraph 27(d) is very broadly drafted and could require the auditor to consider the design and implementation of Human Resources (HR) policies related to the entity's personnel in all parts of the business and at all levels of seniority. We suggest that this requirement be redrafted to restrict the requirement to competent individuals responsible for financial reporting (including senior IT personnel) and for the governance and oversight related to financial reporting.

- Information system controls

Paragraph 36 introduces the concept of 'information system controls', which we do not understand, given the requirement set out in paragraph 38 for the auditor to obtain an understanding of the controls activities component by identifying controls relevant to the audit. If the intent of paragraph 36 is that the auditor is expected to confirm their understanding of the flows of information through the entity's information system and the reporting process used to prepare the financial statements, then we suggest that paragraph 36 be reworded accordingly and that references to 'information system controls' be removed.

27. Grant Thornton International

Reference 1:

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

- The information system and communication component. As currently drafted, we are of the view that this component is a fatal flaw in the ED 315 proposals, as it has achieved neither the clarity nor the scalability objectives. This component includes a requirement to obtain an understanding of the information system relevant to financial reporting. This requirement conflicts with, and potentially negates, the requirement in the control activities component, to evaluate the design and determine the implementation only for those controls that are relevant to the audit. It will result in the auditor understanding and evaluating controls that are not relevant to the audit and that are far more than those necessary to plan and perform an effective and efficient audit.

Reference 2:

- We are of the view that the clear segregation of the components of an entity's system of internal control and the procedures to be performed in respect of each of these components assists with the auditor's understanding of an entity's system of internal control and helps to clarify why that understanding is obtained. We also find the introduction and explanation of "indirect" controls as those controls that likely address risks in the control environment or financial statement level risks, and "direct" controls as those controls that are typically designed to address misstatements at the assertion level for classes of transactions, account balances and related disclosures, helpful.
- We would recommend, however, that paragraph A20 of the proposed standard be clarified regarding the extent of the auditor's risk assessment procedures or that an alternative example is included. As currently drafted, it gives the impression that performing inquiries alone is sufficient, which we do not believe is the intention of this application material.
- Overall, we note that the components, other than the information system and communication component are reflective of the principles established in the COSO Framework. The information system and communication component, however, does not reflect the principles established in the related COSO component. This inconsistency in drafting is the source of some confusion and lack of clarity in the requirements related to understanding and evaluating this component.
- We are concerned with the proposed requirements in the information system and communication component. Specifically, paragraph 35 requires the auditor to "obtain an understanding of the information system relevant to financial reporting, including the related business processes through understanding how information relating to significant classes of transactions, account balances and disclosures flow through the entity's information system." This assumes that the auditor has already made the determination of which class of transactions, account balance or disclosure is significant and that understanding the business process is determined based on the auditor's risk assessment.
- Additionally, the related application material states that understanding the flows of information related to classes of transactions, account balances or disclosures that are not determined to be significant is not required. There may be business processes that do not relate to significant classes of transactions, account balances or disclosures that it is beneficial for the auditor to understand. We are of the view that the focus should first be on gaining an understanding of the business process, which involves gaining an understanding of a transaction from initiation to recording and as such, will likely impact a number of account balances and disclosures, some of which may be significant and some of which may not. We would recommend that paragraph 35(a) of the proposed standard specifically state the understanding of the information system, including the related business processes are in respect of classes of transactions, account balances or disclosures that are expected to be significant to the financial statements.
- Further, the nature and extent of the auditor's understanding of each significant class of transactions, account balance or disclosure may be different. For example, the understanding required for a class of transactions may not be the same as that required for an account balance or for a disclosure. The proposals do not provide guidance on how the auditor's understanding may need to differ.
- We are also of the view that the related application material in this area is somewhat circular in nature and do not believe that merely stating that the process is iterative is helpful.

- The Explanatory Memorandum states that the understanding of the entity's system of internal control is integral to the auditor's identification and assessment of the risks of material misstatement and in particular, that it informs the auditor's expectations about the operating effectiveness of controls and the auditor's intentions to test controls. It further states that, as such, it is the auditor's foundation for the assessment of control risk. However, it does not acknowledge nor discuss how understanding the entity's system of internal control provides important information to the auditor, when making an assessment of the risk of material misstatement, on how the entity understands and manages inherent risk.

28. KPMG IFRG Limited

- In connection with the objective of helping auditors to implement certain requirements of the standard in a more robust and consistent way, the EM notes, at paragraph 30, that significant concerns were highlighted relating to obtaining an understanding of the entity's system of internal control in the IAASB's outreach, including the need for additional clarity to address:
 - Why the understanding is required to be obtained (e.g. when a primarily substantive approach to the audit is planned) and how the information obtained is to be used;
 - What procedures are required in order to "obtain the necessary understanding" for certain components of internal control;
 - Whether all components of internal control need to be understood; and
 - When controls are considered "relevant to the audit".
- We believe that clarifications regarding the above questions are critically important given the feedback the IAASB received during its outreach procedures, and furthermore, given concerns raised by regulators and national standard setters regarding implementation of the requirements of ISA 315 in this area, such as those described in the ICAEW publication, *Risk Assessment and Internal Controls: Continuing Challenges for Auditors* and the CPA Canada Implementation Tool: *Understanding the entity through internal control*.
- We are therefore supportive, in general, of the proposed changes to address the above as we recognize that much of the complexity and scope for inconsistency of application of the requirements of the standard in practice lies in obtaining an "understanding" of the entity's system of internal control.
- "Understanding" is a broad term and, as described in the application material, e.g. at A90 and A102, may be applied differently by auditors depending on the nature of each component of the entity's system of internal control, as well as factors that are specific to the entity, including its size, complexity, IT environment, and previous experience of the auditor with the entity, amongst others. We find the references to the auditor's use of professional judgement in designing and performing risk assessment procedures to obtain the required understanding to be helpful, and furthermore, we particularly welcome the improved distinction between an entity's system of internal control, the components within that system of internal control and the controls within each of these components as well as the improved specificity of requirements pertaining to each of these elements.
- We welcome the sequence in which the components of the system of internal control are presented, to include those that consist primarily of "indirect" controls first, followed by those that consist primarily

of “direct” controls. This differentiation, together with related “evaluation” requirements in respect of each component, which more specifically explain which aspects of each component an auditor is to understand, is expected to help clarify how the understanding of each component will assist the auditor in identifying and assessing the risks of material misstatement.

- We also welcome the clearer delineation between “understanding each of the components of internal control”, as set out at paragraph 25 and “identifying the controls [within those components that are] relevant to the audit” and “evaluating the design and implementation of such controls” as set out at paragraph 26. This distinction more clearly articulates that an auditor is required to develop an understanding of the components of internal control for every audit, whether or not controls relevant to the audit have been identified, or are expected to be identified, and irrespective of whether an auditor plans to perform tests of operating effectiveness over such controls.
- We consider that the inclusion of requirements to “understand” each component of internal control by reference to making specific “evaluations”, as set out in the ED represents a significant enhancement. These evaluations provide greater focus on the specific matters that the auditor is to understand, with a number of “milestones”, e.g. paragraph 28, which states that the auditor shall “evaluate whether the strengths in those areas of the control environment addressed in paragraphs 27(a) to (e) collectively provide an appropriate foundation for the other components of the system of internal control.” In describing the objectives of the understanding, ED-315 helps auditors to determine what to understand for each component and therefore how to do this.
- However, we do have a number of significant concerns relating to certain aspects of the “understanding” section of the ED, which we believe may continue to give rise to confusion and inconsistency in application. These aspects are described below and we suggest the IAASB explore our suggestions for further clarity, with a view to providing enhancements to help support their stated objectives.

Control Activities Component

- We note that the Control Activities component does not appear to be a discrete component of an entity’s system of internal control in the way that the other four components are. This may give rise to confusion, in particular, because the IAASB does not set out differentiated requirements to first “understand” this component and make a specific “evaluation” based on that understanding, and then to identify controls that are relevant to the audit and to evaluate their design and implementation. Instead, the IAASB describes that the understanding of this component is obtained *by* identifying controls in the component that are relevant to the audit and evaluating the design and implementation of these controls.
- As a result, “control activities” and “[direct] controls” (in the Control Activities component) seem to have the same meaning. We suggest therefore that the IAASB select a single, appropriate term and apply this consistently. If the IAASB intends there to be a difference between the terms, we recommend that the IAASB explicitly clarify this difference.

Distinction between Controls within the Control Activities Component and Information System Controls Relevant to Financial Reporting

- As a result of the above, there is a lack of clarity as to how “controls” in the Control Activities component are distinct from “controls” in the other components, in particular, those in the Information

System and Communication component. The ED notes, e.g. at A101, that “direct” controls, which are controls that are designed to prevent, or detect and correct, misstatements at the assertion level, reside mainly in the Information System and Communication component, as well as the Control Activities component. For example, controls within the information system relevant to financial reporting relating to how the entity “corrects as necessary” the transactions (paragraph 35(a)(i)) may often be the controls within the Control Activities component that the auditor plans to test as to whether they are operating effectively (paragraph 39(d)).

- The EM, paragraph 35, and application material at A157 and A166, appear to differentiate between the controls in each component by explaining that the controls (policies and procedures) in the Information System and Communication component, that define the nature, timing and extent of the entity’s financial reporting processes, and how the entity’s personnel, IT and other resources are deployed in applying them, are information system controls relevant to financial reporting, whereas controls in the Control Activities component are controls over the flows of information and the financial reporting processes, and that it is these controls that primarily comprise the “controls that are relevant to the audit”, for which an auditor is required to evaluate the design and implementation. Furthermore, paragraph A 157 states that “controls over information systems are treated as controls in the Control Activities component and may be identified as controls relevant to the audit”. A166 states that “controls relevant to the audit are primarily direct controls and are primarily controls in the Control Activities component because such controls typically are controls over the entity’s information system and address risks of material misstatement at the assertion level”.
- However, we do not consider that this sufficiently clarifies the distinction, and furthermore, we note that paragraph 35 of the EM introduces confusion by stating that “Information System and Communication, and Control Activities components are comprised primarily of controls that directly address the risks of material misstatement at the assertion level”. We therefore recommend that the IAASB further describe the intended inter-relationship between these two components, and the boundary, if any, between the types of controls that reside within each.
- We also note that the description of the Control Activities component is different from that set out in the COSO Framework in that within the COSO Framework, this component is clearly defined, with the inclusion of related, established principles, and descriptions as to how this component interrelates with, or supports the other components of the system of internal control.
- Although we note that the COSO Framework is designed for use in an integrated audit, we highlight that these differences from the COSO Framework, which is a clearly understood framework with a broad global usage, may create confusion, especially given that in other respects the IAASB appears to have sought to increase alignment of key aspects of ISA 315 with the COSO Framework.

Scope for Inconsistent Application of Requirements Regarding Obtaining the “Understanding”

- We appreciate that the ED is attempting to make a distinction between components of internal control that contain primarily direct versus primarily indirect controls and consequently the work effort required by the auditor for each of these components in order to appropriately identify and assess risks and develop the appropriate responses. Our interpretation of the requirements is that the auditor is required to obtain an understanding of the Control Environment, the entity’s Risk Assessment Process, the entity’s Process to Monitor the System of Internal Control, and the Information System and Communication components of the entity’s system of internal control by

performing the procedures set out in the standard but that this understanding does not involve identifying controls, and nor does it involve evaluating the design and implementation of such controls within these components at this point. The auditor is required to identify controls that are relevant to the audit and to evaluate the design and implementation of such controls, at paragraph 39 onwards, based on the understanding obtained.

- It would be helpful if the IAASB were to explicitly state this, in order to drive consistency in application of the requirements of the standard in this area, which is one of the IAASB's stated objectives. In particular, we note that there is scope for confusion and inconsistent application of the requirements in respect of the Information System and Communication component, as we set out below. Additionally, we note that there are discrepancies in the establishment of the evaluation requirements in respect of each component, as we describe below, which may exacerbate confusion in this area. Accordingly, we recommend that the IAASB establish equivalent evaluation requirements in respect of each of the components of the entity's system of internal control.
- As noted above, we welcome the differentiation introduced between the overarching requirements in paragraph 25 (which refer to "understanding" each of the components) and paragraph 26 (which refer to "evaluating the design and implementation" of "controls relevant to the audit"). However, paragraph 25 indicates that to "understand each of the components" of internal control the auditor would refer to paragraphs 27-38. Paragraph 38 addresses the understanding of the control activities component, which is developed *by* identifying controls relevant to the audit and evaluating their design and implementation. As a result, this appears to contradict the intention to demarcate "understanding" and "evaluation of design and implementation of controls relevant to the audit", and instead blurs the distinction by co-mingling these two concepts, which gives rise to confusion.
- We suggest that the IAASB clarify the standard by amending the reference at paragraph 25 to refer to paragraphs 27-37, with paragraph 38 being linked to paragraph 26, since it is addressing controls relevant to the audit. Furthermore, the IAASB could rephrase paragraph 38 to remove reference to "understanding" and to simply state that the auditor is to evaluate the design and implementation of controls relevant to the audit within the control activities component in accordance with paragraph 39.
- Further to the above, paragraph 36 sets out a requirement to "evaluate the design of the information system controls relevant to financial reporting" (that is, the controls within the Information System and Communication component that are relevant to financial reporting per the definition in 16(d)). This paragraph, once again, co-mingles "understanding the component" with "evaluating the design and implementation of controls" and introduces more confusion to the issue that we believe the IAASB was trying to clarify per the EM.
- Accordingly, we believe that the IAASB needs to be explicit as to whether the "evaluation" at paragraph 36 is intended to be:
 - i. An "evaluation" milestone which is performed in respect of the Information System and Communication component, based on the understanding of this component, as a whole, obtained in accordance with paragraph 35, similar to the evaluation milestones for the Control Environment component, entity Risk Assessment component, and Process to Monitor component. A154 seems to suggest this as it states that "the audit evidence obtained by these risk assessment procedures [at paragraph 35] is used by the auditor to evaluate the design

of the information system controls relevant to financial reporting and determine whether they have been implemented.” If this is the case, we recommend that the IAASB clarify this, by prefacing the requirement with similar language to the other evaluation milestones such as “based on the understanding obtained..... in accordance with paragraph 35”, and also by stating more clearly in the application material that the auditor is not required to evaluate the design and implementation of controls other than those that are identified as relevant to the audit in accordance with paragraphs 39-41; or

- ii. An incremental step involving more specific evaluation of the design and implementation of (direct) controls relevant to financial reporting within the Information System and Communication component. If this is the case, we recommend that the IAASB explicitly state this, and also explain how this would assist the auditor in identifying risks of material misstatement at the assertion level.
- We believe paragraphs A166 and A157 appear to support view i) above. In describing the understanding of the information system relevant to financial reporting, we believe the IAASB intends this to mean a “higher-level” understanding of the process overall, such as may be obtained by performing a “walkthrough”, with an overall evaluation performed of the design and implementation of this “process” as a whole, focusing on information flow. This would help to ensure that an auditor develops an appropriate understanding of the flow of information through an entity, including the use of the entity’s IT environment, and through this understanding the auditor is able to design further audit procedures and avoid inadvertent reliance on controls. A200 appears to describe this. A157 states that the auditor may perform a walk-through of a transaction to confirm the flow of transactions relevant to the transaction. A157 further states that at the same time, the auditor may evaluate the design and implementation of controls relevant to the audit that relate to that class of transactions (i.e. over the flow) such as those related to approvals or reconciliations. We believe the IAASB is referring to the iterative nature of the audit here and therefore this is why the concepts of understanding a component and evaluation of design and implementation of controls are co-mingled, but that the IAASB’s intention is to differentiate these requirements.
 - We are supportive of view (i) based on the above, as we consider that improving the auditor’s performance in obtaining an understanding of this overall “process” is an effective means to improve risk identification and assessment, and design a more appropriate audit response.
 - However, we note that the flowchart, and paragraph 35 of the EM, appear to support view (ii). In particular, because they seem to equate evaluating the design and implementation of the controls within the Information System and Communication component to evaluating the design and implementation of controls relevant to the audit. Additionally, it is unclear as to the nature of the “controls” that are to be evaluated in accordance with paragraph 36, including whether these are “direct” or “indirect” controls, and how these relate to the controls relevant to the audit that reside in the Control Activities component.
 - If the IAASB intends paragraph 36 to be in line with view (ii) above, we would be concerned that view (ii) would involve identifying the controls that would be “relevant to financial reporting” in the Information System and Communication component and evaluating the design and implementation of these controls, which, as a corollary of the underlying interpretation of view (ii), would have a much broader reach than controls that are “relevant to the audit”. We believe this may result in an auditor

performing work that is not necessary as it is unclear how this would be helpful to an auditor to identify and assess risks of material misstatements. Although we acknowledge that it could help the auditor to design the audit response, we do not believe it is necessary to evaluate the design and implementation of all controls relevant to financial reporting to design an appropriate audit response.

- Although we recognize that the requirements set out in paragraph 35 make reference to the flow of information relating to significant classes of transactions, account balances and disclosures, which, may be intended to refer, via the concepts of relevant assertions and therefore potential material misstatements, to relevance to the audit, this is a rather circuitous route, and may give rise to confusion in practice. Additionally, since controls relevant to the audit are addressed at paragraphs 38/39 onwards, it would appear to be duplicative to require an auditor to evaluate the design and implementation of controls also as part of obtaining an understanding of this component. Furthermore, given the differences in terminology regarding “controls” used, as described below, and confusion as to which direct controls are in the Information Systems and Communication component versus which are in the Control Activities component, we believe this may lead to inconsistency in practice.
- We believe much of the continued confusion in this area results from the use of “legacy” terminology. In particular, we believe the use of the word “control” in various contexts, without sufficient distinction between different “types” of control, including, in certain instances, between “direct” and “indirect” controls, as well as the use of “control” when the intention may be to refer to a process as a whole, is not appropriate. Additionally, we believe there are certain instances of usage of “control” in a looser sense, to mean an “activity” that may not be a control as such. This makes it difficult for the auditor to understand the intention of, and comply with, the different requirements. We also highlight that the similarity of the terminology “relevant to financial reporting” to “relevant to the audit” also gives rise to confusion as it suggests an intentional symmetry between the requirements at paragraphs 36 and 42.
- If the IAASB does intend paragraph 36 to be in line with view (i) above, then we believe the terminology of “relevant to financial reporting” is intended only to guide the auditor as to where a suitable boundary in relation to their understanding of the flow of information may lie, i.e. that this may be appropriately restricted to financial reporting matters and not wider business matters within the entity more generally. We therefore recommend the IAASB consider revising/further clarifying certain terms, including “relevant to financial reporting” used in the ED, as well as “controls” and “control activities” and, furthermore, that the IAASB state explicitly that an auditor is not required to evaluate the design and implementation of controls, whether “indirect” or “direct” unless they are “relevant to the audit”.

Use of Terminology “to Evaluate”

- In connection with the above, we note that there is inconsistency and lack of clarity in inclusion of the “evaluation” step, such as:
 - Paragraph 24 focuses on the auditor’s evaluation of the appropriateness of the entity’s accounting policies, following the requirement to understand the financial reporting framework at paragraph 23(b), which results in a lack of clarity as to why the auditor needs to understand the entity and its environment as required by paragraph 23(a), other than by reference to the overarching objective set out at paragraph 17;

- The process to monitor the system of internal control does not have a corresponding evaluation requirement;
- In some cases the focus of the evaluation requirement appears too narrow, e.g. at paragraph 24 to “evaluate whether the entity’s accounting policies, and any changes thereto, are appropriate... and consistent”. Whilst we agree that this is an important consideration, we believe that the understanding of the applicable financial reporting framework would go beyond this to involve, as required at 23(b) (i), how it applies in the nature and circumstances of the entity and its environment, including how events or conditions are subject to, or affected by, the inherent risk factors. Such matters would assist the auditor in forming an initial view of risks of material misstatement such as identifying areas of subjectivity/ complexity, susceptibility to misstatement due to management bias or fraud, or matters involving estimates and/or significant assumptions and judgements;
- We have particular concerns regarding the description of the requirement at paragraph 36 to evaluate the design and implementation of the information system controls relevant to financial reporting, as we describe above.

29. MNP LLP (Canada)

- While the requirements are clearer and can be more easily understood, we believe the benefit of obtaining this understanding in the depth that the standard requires may exceed the cost to do so, at least in the short term. Much of our client base (small to medium size businesses) would not necessarily fall into the ‘small, less complex’ category but would also not be considered ‘large, more complex’ entities. Further, many of our clients are still exploring options and starting to adopt new technology solutions in their operations. For many of these audits, a combined approach is not often adopted as the control environment is still in a state of flux, and the types of controls usually implemented (e.g., oversight by owner in an owner-managed entity) in these entities generally cannot be used to reduce the amount of substantive work required. We believe that the client may experience significant cost and disruption while the auditor obtains the required enhanced understanding of the system of internal control, without also experiencing the benefit arising from changes to the auditor’s risk assessment and overall audit approach.
- ED-315 states that the auditor cannot evaluate the implementation of information system controls relevant to financial reporting and the controls relevant to the audit (including general IT controls) by inquiry alone. We are concerned that the nature and extent of work required to adequately assess these controls may approach that required to perform an IT audit. In our opinion, most financial statement auditors do not have the same knowledge and skills as an experienced IT auditor, and there are not sufficient IT auditors in the marketplace to support the financial statement auditors in completing the required evaluation. We believe that it may be necessary to provide additional guidance on the level of work necessary to appropriately evaluate the implementation of controls.
- Furthermore, it is our interpretation that ED-315 requires the auditor to obtain corroborating evidence to support the auditor’s inquiry/understanding of the information system controls. However, we think this level of work effort is perhaps beyond what would be necessary to evaluate the design and implementation of controls when the auditor does not intend to rely on those controls based on their

understanding of the systems. We believe additional guidance clarifying the work effort involved would be beneficial in further understanding the requirements in ED-315.

- Overall, we appreciate that the depth of the requirements in ED-315 for the system of internal control aims to address the quickly evolving business environment. However, given the rapid changes in IT systems and related controls, we think that auditors will struggle to fully understand these controls and how to design efficient and effective tests of controls. Therefore, we recommend that additional interpretation and application resources be provided to auditors on issuance of ED-315.

30. PwC International

- While we believe that the requirements in relation to the understanding of the system of internal control are reasonable when applied in the context of a large, more complex audit, as noted in our cover letter and response to question 2, we do not believe the standard has effectively addressed questions over the scalability of obtaining this understanding when applied to smaller or less complex audits. We believe that the requirements need further clarification for circumstances where the auditor does not plan to seek to obtain audit evidence from evaluating the design and operating effectiveness of controls. We have suggested a two-step model that we believe better reflects the move to performing separate assessments of inherent and control risk (see also our recommendations with respect to control risk).
- We do not believe a detailed understanding of all control activities is necessary, although we acknowledge that some awareness of controls may be of use in understanding where management has determined there to be inherent risk that needs to be managed. Drawing on the concept in paragraph 36 of the ED, when obtaining an understanding of the information system, the auditor will obtain a basic understanding of where the entity has put in place controls relevant to financial reporting that relate to classes of transactions, account balance or disclosures that are significant to the financial statements, or that address journal entries. When the auditor expects to place reliance on controls through testing their operating effectiveness, a detailed understanding of those control activities on which the auditor plans to rely would be required, including evaluating their design and implementation.
- Our suggested redrafted requirements in Appendix 2 identify the matters we believe are relevant to understand for an inherent risk assessment (and therefore required for all audits), and the additional understanding that is relevant when the auditor plans to place reliance on controls. We believe such an approach would be more directly responsive to calls for scalability and bring additional clarity to the nature and extent of understanding that is always necessary when the auditor does not plan to seek to obtain audit evidence from evaluating the design and operating effectiveness of controls. This is an area that lacked clarity in the extant ISA and we believe it is possible to much more clearly articulate the understanding needed.
- Appendix 4 presents our suggestions in Appendix 2 for restructured requirements visually in the form of a flowchart. As we noted in our response to question 1, we would be happy to work with the Board's Task Force to explain our thinking and help further develop this approach.
- We are supportive of the intent of the Board's flowchart developed in relation to understanding the system of internal control, together with the new material trying to better describe direct and indirect controls. We believe the Board's flowchart could be revised to incorporate our alternative structure

described above.

- We also support the changes to terminology to address inconsistent and confusing use of specific terms such as “controls”, “internal control” and “internal controls”.

31. RSM International

- The flowchart dealing with understanding the entity’s internal control is much clearer than the words within the ED.
- In addition, we welcome the intention of ED to set out a more holistic approach to the assessment of Internal Control and risk assessment. The standard could still make it clearer that understanding internal control is an integral part of understanding the entity and identifying and assessing the risk of material misstatement. Auditors who generally perform substantive audits can sometimes struggle to understand why, when no reliance is placed on controls, the ISAs require them to assess Internal Control. We consider, therefore, that there should be a much stronger link between understanding internal control and the risk of material misstatement.
- We have concerns regarding the level of effort required to understand the entity’s system of internal control and when consideration of the design and implementation of controls is necessary. The requirement in paragraph 36 to “evaluate” the design and implementation of system controls relevant to financial reporting is very broad and should be clarified. The language at the end of paragraph 39 notes that not all controls relevant to financial reporting are relevant to the audit, yet the language in paragraph 36 seems to imply that all controls within this component are required to be evaluated. Also, the term, “information systems controls” is confusing and not consistent with other terms used in the requirements. We recommend that the focus of paragraph 36 should be on identifying controls relevant to the **audit** and evaluating the design and implementation of those controls.

32. Office of the Auditor-General of Alberta

- It is clear why the understanding is obtained. We note that throughout the ED there are references to “system of internal control,” “internal control,” “control,” and “controls.” It is not clear if these are the same. We are unsure why the need to refer to “internal control” as a “system” is necessary or how this is distinct from the concept of control as a process.
- We note that paragraph 35 requires the auditor to obtain an understanding of the information system and communication for significant classes of transactions, account balances and disclosures. Herein arises our concern with the intricacy of the definitions and the standard itself. The definition of “significant classes of transactions” is one with one or more relevant assertions, and the definition of relevant assertions is where there is a reasonable occurrence of a misstatement. But for purposes of paragraph 35, how does the auditor conclude the classes of transactions are “significant” if they first don’t understand how these transactions were initiated, recorded, processed, etc. as described in paragraph 35?
- In our view, risk assessment comes first. The auditor first needs to understand how transactions are initiated and processed and recorded, and can then make more informed judgments about significance. The existing requirements in ISA 315.18 are more appropriate, because they used the concept significant to the financial statements.

- We note the theory of the entity underlying the proposed standard is unclear. Specifically, sometimes in the proposed standard it is unclear whether those charged with governance are part of the entity or not. If those charged with governance are part of the entity, then they are part of internal control, and also potentially a source of risk, no different from management as a source of both control and risk (i.e. bias and override). The Board should resolve this issue and provide guidance on how characteristics of those charged with governance may influence risk. Do dual boards increase or reduce risk? Do independent/outside directors increase or reduce risk? In our view, those charged with governance are part of the entity. Paragraphs A112 and A113 provides some guidance, and recognizes that those charged with governance may counterbalance management, but could also stress the importance of the auditor recognizing when those charged with governance are not an effective counterbalance or may have the same biases as management.
- We note guidance could be provided that expands why the auditor obtains an understanding of control and that the auditor need not focus only on the financial statement audit purposes in obtaining their understanding. What we are suggesting is simply an extension of the understanding in A55. The auditor should understand the mission and purpose of the entity. As well, in understanding how the entity creates value, the standard should mention that the auditor may also understand how the entity operates efficiently, with economy, and effectively. Such an understanding helps the auditor form expectations about the entity. For example, an efficiently run entity should have lower costs. If the entity has economy in its purchasing, it may have lower input costs and higher margins.
- We agree with paragraph A46 which recognizes that consideration may be given to broader objectives, and we suggest that it would be helpful to add “broader objectives, such as effectiveness, efficiency and economy, and related risks...”
- The exposure draft in our view does not emphasize enough that the purpose of understanding the entity is two-fold: it is not only risk assessment but also being able to form expectations about the financial statements themselves. The ED does not emphasize enough that risk assessment has a secondary or intermediate purpose, which is to evaluate how much and what types of evidence the auditor should efficiently gather. The standard should emphasize the importance of understanding the entity for analytical procedures, or even more profoundly, being able to form expectations about what is “fair presentation” in the financial statements, which accounts should be there, and what balances should be there. The best auditors will be able to use their understanding of the entity, not to document intricate risk assessments which are a means to an end, but to read the financial statements of the entity and say that “sales looks wrong because I know it should be \$X higher because I know they had at least 5 large contracts completed worth \$Y.” In other words, to evaluate whether the information on performance and financial position being communicated by the financial statements is fairly presented, or compliant with the applicable reporting framework.

33. Office of the Auditor-General of Canada

- Yes, the requirements related to the auditor’s understanding of each component of the entity’s system of internal control are clear with the exception of paragraph 36 which states the auditor “shall evaluate the design of the information system controls relevant to financial reporting”.

35. US Government Accountability Office

- We believe that it is clear why the auditor should obtain an understanding of each component of the entity's system of internal control and how this understanding informs the risk identification and assessment process. To appropriately enhance the requirements related to the auditor's understanding, we suggest that the IAASB consider whether the standard should emphasize the interdependency of the components of internal control on the design, implementation, and operating effectiveness of controls. The standard could include guidance that the auditor cannot conclude on the effectiveness of internal control unless the auditor has evaluated the design, implementation, and operating effectiveness of internal control for all components of internal control. Our understanding of ED-315 is that the auditors will be required to obtain an understanding of each component of the entity's system of internal control, but will only be required to evaluate design and implementation for (1) information system controls relevant to financial reporting and (2) control activities relevant to the audit. The Committee of Sponsoring Organizations of the Treadway Commission's 2013 Internal Control—Integrated Framework provides that if a component or relevant principle is not present and functioning, or the components are not operating together in an integrated manner, then a system of internal control cannot be effective. Therefore, we suggest that the IAASB consider adding guidance that the auditors may consider evaluating the design and implementation for all components of internal control during their identification and assessment of risks of material misstatement if they intend to conclude on the effectiveness of internal control.
- Also, in paragraph 30, we suggest that IAASB delete "the auditor shall evaluate whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process." We believe that if the auditor identifies risks of material misstatement that management failed to identify, the auditor should obtain an understanding of why the entity's risk assessment process failed to identify such risks and consider the implications for the determination of whether the nature of the entity's risk assessment process is appropriate to its circumstances. We believe that the auditor should obtain this understanding and consider the implications regardless of whether the auditor would have expected management to identify the risks.
- Lastly, in paragraph 37, we believe that auditor's understanding of how the entity communicates financial reporting roles and responsibilities and significant matters relevant to financial reporting should include an understanding of communications between management and entity personnel.

36. Swedish National Audit Office

Reference 1:

We believe that the proposals relating to understanding the entity's system of internal controls overall will assist the auditor in understanding the nature and extent of the work required. Though we find some areas to be too detailed and less principle-based while others (IT part) need to be clarified to ensure consistency in practice.

Reference 2:

Yes, we agree, but find the requirements to some extent too detailed, for example in paragraph 27, where d. and e. will be better suited in the application material.

38. ACCA-CAANZ

We are concerned that some elements of the control environment as per paragraph 27 might be hard to evidence. Therefore, we would expect some guidance in the form of examples of what documentation might be expected.

39. Accountancy Europe

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

40. AICPA

Reference 1:

Understanding Internal Control

We suggest that the IAASB more fully articulate in the standard why it is necessary to gain an understanding of internal control in an audit of financial statements. For example, in an audit of an entity's financial statements, the objective of gaining an understanding of internal control is to provide a reasonable basis to assess control risk and thereby assess the risks of material misstatements. The auditor's understanding of internal control also may inform the auditor in designing and performing the nature, timing, and extent of further audit procedures. Finally, while gaining an understanding of internal control, the auditor may identify deficiencies in internal control that would be required to be communicated to those charged with governance and management in accordance with ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance*.

Reference 2:

- We appreciate the IAASB's efforts to expand and clarify the auditor's approach to the understanding of the system of internal control and how and why it is a critical element of the risk assessment process. We note that for many practitioners this is an area that is often not well understood with respect to the need for an appropriate understanding and how the outcomes impact the responses to identified risks. As such, we have provided the following specific recommendations.
- We note that often there is a strong interaction between opportunities for committing fraud and the appropriate design and implement of an entity's system of internal control. For these reasons and

others such as the expanded use of IT by nearly all entities, we recommend the standard address the notion that in most circumstances it is generally not possible for the auditor to adequately design further audit procedures, including appropriately addressing the risk of fraud, without gaining such an understanding of the system of internal control.

- We further recommend the standard provide guidance to the auditor regarding the need to consider the reason(s) management designed and implemented controls, as one source of information about potential risks of material misstatement and note that this aspect of risk assessment is only available when the auditor has obtained an understanding of internal control.
- Highlighting the above points, which we believe are fundamental reasons for the requirement to obtain an understanding of internal control in all audits, in the introductory section of the standard may be helpful in articulating the conceptual basis for the requirement.
- We understand the standard uses the elements of internal control described in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). If it is the intent of the IAASB to be consistent with COSO, we believe that the guidance in the standard should be consistent with the guidance in COSO. For example, it appears that the “information and communication” element in ED-315 may not be consistent with how this element is described in COSO. To enhance auditors’ comprehension of the requirements in this part of the standard, we recommend the standard use a description of the elements that is consistent with COSO, since it uses the same terms and categorization.
- Paragraphs 27–34 — We are concerned about the requirement to evaluate the control environment and risk assessment components (paragraphs 28 and 31a) based on the procedures listed in paragraphs 27 and 29. We believe the requirement should be limited to obtaining an understanding sufficient to assess risks of material misstatement. We recommend the section that discusses obtaining an understanding of the monitoring component (paragraphs 32–34) as an appropriate term for articulating the extent of the understanding that is necessary, without requiring the auditor to make an evaluation that may be premature.

41. Center for Audit Quality

Level of Effort to Understand the Entity’s System of Internal Control

- As set forth in the Explanatory Memorandum that accompanied the Exposure Draft, the IAASB intended to clarify in the Exposure Draft what is meant by “controls relevant to the audit”, what is expected of auditors to obtain an understanding of controls, and how the concept of controls relevant to the audit relates to the information system. However, we do not think that objective has been met. It is essential that the IAASB’s efforts result in greater clarity as to what is expected of auditors with respect to internal control to minimize confusion and inconsistency in application.
- We are concerned that the potential implications of a separate “assessment” of control risk have not been appropriately considered, nor is the Exposure Draft sufficiently clear about the nature of what is expected. While auditors do consider control risk in identifying and assessing risks of material misstatement, it is in the context of whether to obtain evidence from evaluating the design, implementation and operating effectiveness of controls. Auditors also consider control risk when performing substantive procedures, either alone or in combination with control procedures in the risk

assessment and planning stage, to help determine the planned control reliance. Therefore, we believe it is necessary for the final standard to clearly illustrate that auditors may think about this assessment within their methodologies in a variety of ways, including by considering how planned controls reliance can appropriately reduce the overall risk of material misstatement.

- Paragraphs 27 to 38 of the Exposure Draft outline the requirements the auditor should perform to obtain an understanding of each component of internal control. Paragraph A90 of the Exposure Draft provides guidance that the nature, timing, and extent of risk assessment procedures that the auditor performs to obtain an understanding of each component of internal control are matters of the auditor's professional judgment. In particular, the auditor's approach to understanding the entity's system of internal control could vary based on the size and complexity of the entity, as well as prior experience with the entity, and still be in compliance with the requirements. We would recommend the introductory paragraphs of the final standard make specific reference to the fact that the ISA requires the auditor to perform risk assessment procedures that, in the auditor's judgment, are appropriate based on the size and complexity of the entity.

Terms Used to Describe Aspects of the Entity's System of Internal Control

- Similar to the definition of *Internal Control* in extant ISA 315, the definition of the *System of Internal Control* in the Exposure Draft makes reference to achieving operational and compliance objectives. We recommend the Exposure Draft make clear that, while the system of internal control would include processes and controls related to operational and compliance objectives, not all of the entity's objectives and controls are relevant to the auditor's assessment of the risks of material misstatement at the financial statement and assertion levels. For example, the auditor's responsibility for internal control related to cybersecurity and/or privacy would be limited to those cybersecurity or privacy controls relevant to the audit.
- Paragraph 16(d) of the Exposure Draft defines controls as, "Policies or procedures that are embedded within the components of the system of internal control to achieve the control objectives of management or those charged with governance. Within this context, policies are statements of what should or should not be done within the entity to effect internal control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions. Procedures are actions to implement policies." We note this definition comes from the Committee of Sponsoring Organizations (COSO), but believe additional context is necessary to describe that internal control is a process consisting of ongoing tasks and activities that is impacted by people.
- Similarly, we note the definition of controls refers to policies, including those implied through actions and decisions. While this aligns with COSO, we believe additional context would be necessary to operationalize the term in an audit context to support the expanded requirements for auditors to evaluate design and implementation of controls relevant to the audit. Evaluating the design and implementation of a control implied through an action or decision can be difficult. We recommend application guidance be added to the Exposure Draft to describe the nature and extent of procedures an auditor could perform, such as observation of activities or inspection of less formal documentation, when documentary evidence of the operation of the control might not exist. We note this guidance may be particularly relevant for auditors dealing with less sophisticated entities.

42. Chartered Institute of Public Finance & Accountancy

The proposed revised ISA contains new material related to the auditor's understanding of internal control. As noted in the covering letter, CIPFA considers that the main body of the standard contains too much detail: in consequence it may be less successful in explaining why the auditor needs to obtain an understanding and how this relates to the identification and assessment of the risks of material misstatement.

43. CPA Australia

Whilst the understanding of each internal control component has been enhanced, what to do with that understanding is not clear for each component, such as how that understanding links to testing of design and implementation. In addition, the relationship between the evaluation of the control components and the risk identification and assessment is not clear in the requirements, although it is touched on in application material (paragraph A201). It is difficult to follow the flow of the standard and how the different sections relate to one another, albeit that those relationships are complex and do not represent a step by step process. We suggest further consideration of the outcomes the auditor is seeking under each section of the standard and then making sure that those are clearly articulated. We suggest that the following specific matters are considered:

- Some of the requirements in paragraph 27 will be difficult to apply, in that they are very difficult to test or document adequately and may be better placed in application material. For example, the understanding of the control environment required includes how the entity "demonstrates commitment to integrity and ethical values" as well as "a commitment to attract, develop and retain competent individuals in alignment to its objectives". In addition, we suggest that this paragraph should be worded "whether" rather than "how" as indeed the entity may not be able to demonstrate that they do the things listed in that paragraph.
- Paragraphs 30 and 31 seem to relate to ways by which the auditor may assess whether the entity's risk assessment process is designed and implemented effectively, but does not articulate this.
- Paragraphs 32-34 require an understanding of the entity's process to monitor the system of internal control but do not explain what to do with that understanding. There is no requirement for the monitoring controls be tested for design and implementation and yet it is not clear how these can be relied on without doing that testing.
- Paragraphs 36 could be expressed in a similar way to paragraph 38 to cover understanding, design and implementation of the information and communication, before providing the detail in paragraph 35 and 37 about how that understanding may be obtained. It is somewhat confusing currently.

44. EFAA

- We question the need for auditors to understand controls where a wholly substantive audit approach is taken. We believe, and our research cited above supports, some high level understanding of controls, and particularly the controls environment, is necessary regardless of the audit approach. We fear, however, that the extent of design and implementation work required under these proposals and the volume of material on controls and IT generally will only re-enforce the belief in many that ISAs undermine the cost effectiveness and efficiency of smaller audits.

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

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

The concepts included in relation to the five components of the internal control system as well as the implication in "direct" and "indirect controls" improve the understanding that the auditor must obtain in the risk identification and evaluation process.

47. FSR Danske Revisorer

- From a scalability standpoint, it is in our opinion not appropriate to require that all components of an entity's internal control system are understood. This is for example, the case where a decision is made by the auditor to apply a substantive based audit approach, rather than relying on and, therefore, testing internal controls more extensively.
- In our view, the need to understand each component of internal control system should be scaled to the size and complexity of the entity being audited.

48. Interamerican accounting association (South America)

Reference 1:

Yes, we understand that the proposals made in the draft amendments to ISA 315 (Revised) will help deepen the auditor's understanding of the different elements of the entity's internal control to further understand the nature and scope of the work to be undertaken by the auditor, referred to the identification and determination of the risks of material error for the purposes of an audit of financial statements. Specifically regarding the following matters:

Reference 2:

Yes, the profound changes proposed in the draft have ostensibly improved and adequately clarified the requirements necessary for understanding the components of the internal control system related to the financial statements of the entity. The reasons why the auditor needs to obtain an understanding of such internal control elements and their impact on the financial information to be audited, with the proposed changes, are clearer than in the current ISA 315 (Revised), and it is more understandable through the flowcharts of how understanding the internal control system helps the auditor to understand more clearly the process of identifying and subsequently evaluating significant risks for their audit of financial statements, to determine which tests to apply, in what time and with what scope, in order to obtain supporting evidence of quality to sustain their reports.

49. Instituto dos Auditores Independentes do Brazil

Yes. We support the requirements in relation to the understanding of the system of internal control in driving the nature and extent of the work effort required.

51. Institute of Chartered Accountants in England and Wales

The rationale for understanding internal control

- The reason given in paragraph 31 of the Explanatory Memorandum for requiring an understanding of internal control includes the following wording:

‘In particular, the understanding informs the auditor’s expectations about the operating effectiveness of controls and the auditor’s intentions to test controls.’
- If IAASB wishes to change the behavior of auditors who do not believe that they should have to take any account of controls when performing what are (sometimes erroneously) described as ‘fully substantive’ audits, it needs to be clearer than it is at present about the fact that understanding internal control is an integral part of understanding the entity and identifying and assessing the risk of material misstatement. Controls only exist to mitigate perceived risks and understanding the existence and quality of controls – regardless of whether this is by means of work on design and implementation or by other means - constitutes important evidence about how the entity understands and manages risk. This is the primary reason for understanding internal control. It is not, as described in paragraph 31, simply to decide whether or not to test the operational effectiveness of controls and to inform expectations about their effectiveness.
- The idea that control risk is irrelevant to the audit risk model in fully substantive audits is not based on the idea that controls are irrelevant, but that control *risk* is only relevant if the operational effectiveness of controls is to be tested. It makes no sense to require auditors to assess control risk as maximum if control risk is irrelevant. IAASB should make a stronger link between the need to understand controls in order to understand the business and the risks management believes it is mitigating using those controls.
- In this context, the flowchart dealing with understanding the entity’s internal control is much clearer than the words. Towards the bottom right, the chart refers to design and implementation work on controls (paragraph 42) and suggests that problems identified through design and implementation work might lead to the identification of risks of material misstatement at the assertion level (‘the output contributes to the risk of material misstatement at the assertion level’). This seems sensible: if walkthrough tests suggest problems, the risk assessment and/or the nature and extent of substantive testing should change in response.
- The purpose of work on controls is to enhance the understanding of the risk of material misstatement, which the flowchart seems to allow for, but the wording of the relevant paragraphs in the ISA is much less clear. The assumption seem to be that testing the operational effectiveness of controls is the default position. Auditors of many smaller entities, and auditors making extensive use of sophisticated data analytics techniques in some larger and more complex audits, might challenge this assumption. A controls-based audit approach is far from the norm in audits of any size and data analytics and other automated tools and techniques may eventually render it redundant.
- It seems that for some audits, work on understanding controls, including design and implementation work, is perceived as having value both for the audit, and for the audited entity. Our outreach indicates strongly that one important reason for performing work on internal control that the ISA could emphasize more is the fact that in audits of all sizes auditors rely on system-generated reports inappropriately. Where controls are considered, the focus is often on high level general controls rather

than on the specific IT controls over the reports on which the audit work is performed, or over journal entries, for example. Audit regulators comment on this in their inspections of audits of all sizes. This is brought out in application material but it warrants further elaboration and an example, perhaps involving analytical procedures performed on a receivables listing. This might refer to the work that would need to be performed on the listing in a simple situation to provide evidence regarding its integrity in terms of completeness and accuracy – before the analytical procedures are performed – without any reference to internal controls over the production of the listing.

- In other audits, it seems that work on controls is perceived as having less value. Our outreach indicates that the audit work performed on controls in some cases varies little, regardless of the quality of the entity's controls, rendering that work largely redundant. Once again, this issue is not restricted to the audits of smaller entities. The problem is that neither the extant standard nor the proposals make any attempt to acknowledge these issues. Even some larger firms are moving away from testing controls, and from performing analytical procedures, towards more extensive tests of detail. If this trend is accelerated by advances in the use of data analytics, some of the detailed new material on controls and IT may become redundant in a relatively short period of time. We therefore urge IAASB to consider whether some of the new material on IT might be moved to separate appendices, particularly given that much of it is only relevant to larger audits, and much of it is untested.
- IAASB should not defer consideration of the fundamental issues regarding the nature and extent of work needed to understand controls where the operational effectiveness of controls is not tested, and a fully substantive audit approach is taken. There is a body of opinion among practitioners that strongly believes that for some such audits – and not just smaller audits – the work required by the extant standard on the design and implementation of internal controls is inappropriate because it is predicated on the implicit assumption that controls will in fact normally be tested for operational effectiveness. Other approaches to the necessary understanding of controls are possible and we urge IAASB to consider this issue in finalizing this standard, and not to defer it. The issue is too important and too urgent to be left to the project on the audit of less complex entities.
- **Direct and indirect control components:** the introduction of the notion of direct and indirect control components and their relationship with risks at the financial statement and assertion levels is helpful. As application material, it represents the approach taken in many audit methodologies and will thereby clarify best practice. Our outreach indicates that even so, this is an important development and that more guidance is needed to prevent misunderstanding. To some, this will appear to be just another area of new terminology.
- **Control environment:** there is an increased focus on corporate governance and consequently on understanding the control environment. While guidance for the audit of those many smaller entities in which the control environment is informal has been enhanced, it remains limited. Where a fully substantive audit approach is taken, it is hard to gauge the extent and depth of work required on the control environment.
- **Control activities:** there is no clear distinction between controls within the control activities component and controls in the other components, particularly the information system and communications component. This seems to diverge from the COSO model and the explanation that controls in the control activities component are controls 'over' the flows of information and the

financial reporting processes is weak and unclear. We do not understand why these changes have been proposed.

52. Institute of Chartered Accountants Ghana

Yes, we believe that it is clear. The requirements with regards to the auditor's understanding of each component of the entity's internal control system is appropriately enhanced and clarified. This is evident in the fact that the IAASB has set out within each component which matter need to be understood. The IAASB has made it very clear why the understanding needs to be obtained and how this informs the risk identification and assessment process. The identification of 3 components as indirect and 2 components as direct serve to highlight easy identification of these components and how they relate to the system of internal controls. The guidance, actually breaking down what each of these components contains is also very useful. Finally, the flowcharts (especially the entity's system of internal control flowchart) are quite useful in situating how each of these components is to be understood and how they relate to one another in arriving at the identification of the risks of material misstatement.

53. Institute of Chartered Accountants of Pakistan

We note that the enhancements in ED 315 provide further clarity in relation to what is required when obtaining an understanding of each component of the entity's system of internal control and how this informs the risk identification and assessment process.

54. Institute of Chartered Accountants of Scotland

- We agree that the auditor's understanding of each component of the entity's system of internal control, if it is relevant to financial reporting, is a prerequisite of assessing control risk during the risk identification and assessment process.
- However, from a scalability perspective, we do not consider that understanding and documenting all components of the entity's internal control system or assessing the design and implementation of controls, is required for entities in a simple and low-risk environment for which a full substantive audit approach will be adopted. Requiring such work could prevent the auditor's resources being applied to more valuable aspects of the audit and potentially result in significant audit documentation which is of little value and could obscure the real audit issues.

55. Institute of Chartered Accountants (Zimbabwe)

The requirements related to the auditor's understanding of each component of the entity's system of internal control have been clarified by the flow charts. The five components of the system of internal control process have been identified and guidance has been provided in the flow chart.

56. Institute of Internal Auditors

Although the following response does not follow the question-and-answer format identified in Section 4 Request for Comment, its content does apply to questions 4 and 6 generally and most particularly to 5(a), 5(b) and 9(d).

- No discussion of ISA 315 can ignore its close association to ISA 610. The latter includes direction for evaluating the extent to which external audit should rely on the work of internal audit. This includes taking account of internal audit's **objectivity, competency, approach** and **quality control**.
- Simply put, external auditors can and should rely on the work of internal audit when the internal audit function is independent, appropriately resourced, and follows The IIA's *International Standards for the Professional Practice of Internal Auditing*. Therefore, the sole test of the reliability of internal audit's work should focus on conformance to the *Standards*, including assessing the function's status within the organization.
- The fundamental purpose of the *Standards* is to provide practitioners with guidance and direction for successfully performing professional internal auditing. The *Standards*, part of the *International Professional Practices Framework* (IPPF), includes attribute standards that address both individual and organizational **independence** and **objectivity** (Standards 1100, 1110, 1112, 1120, 1130), **proficiency** and **due professional care** (Standards 1200, 1210, 1220), and **quality assurance** (Standards 1300, 1310, 1311, 1312, 1320, 1321, 1322).
- Additionally, The IIA's performance standards further direct practitioners on managing the internal audit activity, as well as planning and executing engagements. Implementation guidance provides additional direction on applying the *Standards*. This comprehensive, tested, and proven set of professional canons provides what practitioners need to conduct high-quality internal audit and should be the only measure of internal audit independence, objectivity, competency, and quality. The IIA urges IAASB to reconsider its direction to external auditors regarding reliance on the work of internal audit by specifically focusing on three areas:
 - Conformance to IIA *Standards* is fundamental to internal audit competency and quality and, therefore, should be the only barometer of whether internal audit can be relied on. Otherwise, the test is at best subjective and at worst runs the risk of a perception of self-interest.
 - Recognizing audit committee oversight relating to internal and external audit operations is integral to understanding internal audit's status in the organization.
 - Reviewing the possibility that ISA 315 (revised) and ISA 610 (revised), as currently constituted, could create a perception of self-interest bias by the external auditor in the public's view.

These three points are further examined below.

Conformance to IIA *Standards*

- The work of external audit — providing assurance on the accuracy of financial reporting — is a complex operation. Adding to the challenge, external auditors face increasing pressure from boards, regulators and activist investors to identify material weaknesses in internal controls.
- A generally accepted definition of material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.
- Identifying such weaknesses requires a thorough and sophisticated understanding of internal control within the organization. Internal audit's place as an independent and ongoing assurance provider on

internal controls across the organization makes it the default expert. In its limited and periodic review role, external audit cannot be expected to have as comprehensive an understanding of internal control.

- Conformance to IIA *Standards*, as well as other components of the IPPF, endorses that the function is independent, is operating to a strict code of ethics and defined professional standards, undergoes periodic internal and external quality assessments, and its staff is trained to specified standards of educational and continued professional development.
- In addition, using the work of internal audit should not be a reactive or ad hoc process. There is scope for internal and external audit to communicate plans in such a way as to coordinate activity with a view to supporting and assisting each other as appropriate. When properly planned, this cooperation and the benefits it promotes do not affect the independence of either party.
- Research by the Center for Audit Quality and The IIA in 2014 concluded that collaboration among the audit committee, internal audit and external audit help organizations succeed.

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

The Role of the Audit Committee

- As mentioned previously, ISA 315 and ISA 610 identify an evaluation of internal audit’s independence, competence, approach, and quality control as the basis for determining whether its work can be trusted. However, this direction fails to account for the significant role the audit committee plays in determining the efficacy of both internal audit and external audit.
- Audit committee oversight of both internal audit and external audit affects how assurance is provided to the organization. Audit committee support is vital to internal audit independence, scope, and resources.
- Therefore, any evaluation of the internal audit function must include an examination of whether the audit committee is fulfilling its oversight responsibilities. It is this oversight that ensures the independence of both internal audit and external audit, by:
 - Ensuring adequate resourcing.
 - Coordinating and aligning the internal audit plan and external audit engagements.
 - Appointing and evaluating the need for periodic rotation of the external auditors.
 - Hiring, firing and compensation matters relating to the chief audit executive (CAE).
 - Performing due diligence to ensure the competence of internal auditors and external auditors.
 - Considering reports received from internal auditors and external auditors.

Self-interest Concerns

- Finally, the IAASB should consider two potential hazards associated with the current approach to determining the reliability of internal audit's work: variability across the profession in how evaluations are made (due to the current absence of objective, defined criteria), and subjectivity in an individual external auditor's evaluation. These could contribute to the threat, or appearance, of self-interest bias because a determination that the work of internal audit is unreliable increases the amount of work and related fees required by external audit.
- This risk of self-interest bias is compounded by direction in ISA 315 and ISA 610 that precludes the use of some of internal audit's work out of hand.

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

- This default position regarding significant areas of risk itself creates unintended risk by dismissing internal audit's work outright and renders any evaluation of the function's objectivity, competency, approach, and quality moot.
- If anything, this is the area where internal audit's work should be most valued. As mentioned earlier, internal audit's place as an independent assurance provider on internal controls across the organization makes it the default expert. Indeed, risk-based internal auditing by definition is built on providing assurance on risk management and internal control. Internal audit planning, resource allocation and focus — in close consultation with senior management and the board — are driven by the significance and likelihood of these risks.
- Once reliability has been determined — based on conformance to IIA *Standards* and an examination of the oversight role of the audit committee — that reliability is absolute across the work of internal audit. It does not lessen because more judgement has been required or the risks are higher. Once again, this direction in ISA 315 and ISA 610 raises the risk, or perception, of self-interest bias.
- The IAASB should consider providing the external auditor an “apply-or-explain” option with regard to reliance on the work of internal audit. An external auditor that concludes the work of internal audit is not reliable should provide details for how that conclusion was reached. For example, the work of internal audit may not cover or fully cover the scope of what the external auditor is seeking to address. Without such an “apply-or-explain” option, the risk or perception of self-interest bias remains.
- It may be beneficial to examine the parallel direction in IIA *Standards* on reliance on outside assurance providers. IIA Standard 2050: Coordination and Reliance addresses how a CAE should approach and assess the work of other assurance providers.

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

- Not unlike ISA 610, the related interpretation of the standard identifies the need for the CAE to consider “the competency, objectivity, and due professional care” of the external assurance

providers. It also goes on to direct CAEs to have “a clear understanding of the scope, objectives, and results of the work performed.” However, it does not limit reliance on the work of the external assurance provider, once its reliability is established.

57. Institute of Public Accountants

Reference 1:

- Substantive testing bias – The IPA is of the view that the application of ISA 315 by auditors has been affected by a bias in auditing towards substantive procedures. Many auditors are reluctant to allocate scarce audit fees to documenting and understanding the system of internal control. As it is not appropriate to rely solely on tests of controls (ToCs), auditors often believe it is more efficient not undertake such audit procedures. This tendency is reinforced by the risk that if controls-based approach is adopted and the ToCs indicate the controls are not reliable, the auditor will have to undertake the same level of substantive testing as they would have if they had not undertaken the controls-based approach.
- Insufficient emphasis on understanding transactions – while the standard emphasizes the need to understand the system of internal control, the need to understand how transactions are recorded in the general ledger and financial statements is not given the same emphasis. The IPA believes the current inclination by auditors to adopt a substantive audit approach and not rely on controls has reduced auditors understanding transaction flows, i.e. if controls are not relied upon transaction flows are not required to be understood and documented.
- ISA 315 should be “re-balanced” so that the auditor has a primary obligation to understand the transaction flows of the client and document them. The requirement to identify controls should be a bi-product of this process. The guidance should also indicate that adjustments and balances outside the transaction systems should have higher inherent risk due to possibility of management override and bias.

Reference 2:

Inter-relationship of inherent and control risk – the proposed amendments to ISA 315 do not provide any indication as to the relationship between the control environment and inherent risk. There is a view that inherent risk is mitigated by a strong control environment, however a weak control environment cannot increase inherent risk (i.e. a high inherent risk can't be made worse by a poor control environment). An alternative view is that inherent and control risks are additive. ISA 315 is not clear on this relationship. In any event, it is arguable that certain aspects of inherent risk could be categorized as control environment elements e.g. governance structure, management experience, and propensity for misstatement. The IPA believes further guidance should be given in relation to such factors.

58. Institute of Singapore Chartered Accountants

- ED-315 stipulates the specific matters relating to each component of internal control that auditors need to understand. We are of the view that in general, these requirements have been appropriately enhanced. We have identified areas that need further clarification in the subsequent paragraphs.
- We believe that further clarification is needed on why this understanding of the entity's system of internal control is required and how the information obtained is to be used as part of risk assessment.

This is especially so when a primarily substantive audit approach is adopted. For example, paragraph A102 of ED-315 could be further enhanced to demonstrate how understanding the information system and control activities can affect the identification and assessment of risks of material misstatement at the assertion level.

59. Malaysian Institute of CPAs

- Yes, the requirements related to the auditor's understanding of each component of the entity's system of internal control have been appropriately enhanced and clarified. It is clear why the understanding is obtained and how this informs the risk identification and assessment process.
- Overall, the proposals made relating to the auditor's understanding of the entity's system of internal control, as set out in Para 25-44, do assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks or material misstatement. The usefulness of the guidance materials could be enhanced if examples of the nature and extent of the understanding of the system of internal control for smaller entities with less sophisticated IT systems and informal documentation around the system of internal control can be provided.

60. New York state society of CPAs

In our view, the requirements have been met. However, to provide further clarity, we recommend (before paragraph 29) that "The Entity's Risk Assessment Process" be removed or incorporated into other internal control component headers. We also recommend (before paragraph 32) "The Entity's process to monitor the system of internal control" be changed to "The Monitoring Process."

61. PAFA

While there is consensus that the requirements relating to the auditor's understanding of each component of the entity's system of internal control have been appropriately enhanced and clarified, there is some concerns that it is not always clear how an understanding should be obtained, i.e. should the auditor always use observation and inspection in addition to inquiry or when would it be a requirement of the auditor to use observation and inspection?

Another concern relates to the manner in which information system controls (paragraphs 35 to 37), control activities (paragraph 38) and controls relevant to the audit (paragraphs 39 to 42) have been structured:

- Information system controls and control activities are the two components that comprise direct controls and, by their nature, they are very closely related. For example, the flow of information as part of a particular business process, including how transactions are initiated, recorded, processed and corrected, will also encapsulate control activities such as authorizations and approvals, reconciliations and verifications.
- It is peculiar why the control activities component is presented and structured in a different manner compared to any of the other four components. Furthermore, why is it necessary to link controls relevant to the audit primarily to the control activities component and not also to information system controls? To illustrate, it would be possible to also identify the controls listed in paragraph 39(a) to (e) with controls in the information system and communication component.

- The interrelatedness of the information system and communication component, and the control activities component is acknowledged in paragraph A160: "Controls in the control activities component include those controls over the flows of information within the information system relating to significant classes of transactions, account balances and disclosures and the financial reporting process used to prepare the financial statements."
- There are further indications of this interrelatedness (for example, paragraphs A166 and 40) and, hence, that it is more appropriate to assert that controls relevant to the audit are primary controls in the information system and communication, and control activities components (i.e. direct controls).
- It is proposed that higher level of clarity may be achieved if the control activities component is presented and structured in the same format as the other components, followed by the "Controls relevant to the audit"-section. The latter being based on the notion that controls relevant to the audit are primarily identified from the direct controls components, namely the information system and communication, and control activities. It may then also be possible to only address the "design and implementation" requirement once, whereas it is now split between paragraphs 36 and 42 (although some thought would need to go into whether the robustness of the auditor's understanding of an entity's direct controls may be compromised).

62. SAICA

- 71% (82/116) of the survey respondents predominantly agree that the requirements relating to the auditor's understanding of each component of the entity's system of internal control have been appropriately enhanced and clarified. Some of the individual text comments provided seem to indicate that some members still get stuck on "why an understanding is required, when there is no intention to place any reliance on internal controls". Based on the balance of comments which the IAASB may receive in this regard, it could be necessary to consider whether the messages around the benefits to the auditor of obtaining an understanding of the system of internal control (and its components relevant to financial reporting) come through strong enough.
- Extant ISA 315.A106 describes the minimum transaction cycles that the auditor is likely to obtain an understanding of in the audit of a smaller entity, namely: revenues, purchases and employment expenses. It was identified that this paragraph has not been retained in the ED. SAICA's outreach indicates that the guidance in the extant standard is helpful to auditors in indicating a certain minimum level of work effort and, hence, the suggestion put forward was to reinstate this in the application material. A different perspective is that the understanding required regarding the entity's business processes under ED-ISA 315, paragraph 35 is driven by what is identified as significant classes of transactions, account balances and disclosures, and would therefore direct attention and work effort to the relevant business processes.
- In response to a further question, 78% (84/108) of the survey respondents agree that it is clear why an understanding is obtained and how this informs the risk identification and assessment process. We also believe that the flowcharts may have contributed to respondents' understanding in this regard (also refer to the comments to question 1, above).
- The introduction of the concepts of *direct controls* and *indirect controls*, and distinguishing identified components of a system of internal control within these categories are helpful in contextualizing the understanding the auditor requires, including the related work effort and how such understanding

flows through to the identification and assessment of risks of material misstatement. It is suggested that the IAASB consider introducing this earlier in the standard, for example, as part of the application material to the definition of “System of internal control”, and identifying additional places in the application material to each component of the system of internal control where this distinction can be reinforced.

- Some comments from survey respondents imply that it is not always clear how an understanding should be obtained, i.e. should the auditor always use observation and inspection in addition to inquiry or when would it be a requirement of the auditor to use observation and inspection? We believe that such uncertainty may be related to the distinction between “internal control relevant to financial reporting” and “internal control relevant to the audit”:
- Paragraph 25 requires that the auditor perform *risk assessment procedures* (i.e. as defined in paragraph 16(i) and further described in paragraph 18 and its related application paragraphs). Then, paragraphs A153 (in relation to the requirement in paragraph 36) and paragraph A198 (in relation to the requirement in paragraph 42) address *risk assessment procedures* to obtain audit evidence about “design and implementation”, but in this case stating that inquiry alone is not sufficient for such purposes. Therefore, is the implication that in other instances, such as generally obtaining an understanding about the controls relevant to financial reporting, inquiries alone would be sufficient? A possible solution could be to try and clarify upfront that risk assessment procedures are multi-purpose procedures depending on the context in which they are applied and the objective to which they are directed. This could be illustrated in relation to controls relevant to financial reporting and controls relevant to the audit.
- Further to the matter addressed above, it is our view that paragraph A153 should be reworded as follows in order to ensure a higher level of consistency between paragraphs A153 and A198:

“The auditor’s understanding of the information system may be obtained in various ways. ~~The auditor’s~~ Risk assessment procedures to obtain audit evidence about the design and implementation of the information system controls relevant to financial reporting ~~such understanding~~ may include, for example, a combination of ...”
- Another comment received from the survey is that auditors struggle to differentiate between obtaining an understanding, evaluating the design and implementation and testing the operating effectiveness of internal control; the more prominent uncertainty being that between obtaining an understanding and evaluating design and implementation, together with the distinction between “internal control relevant to financial reporting” and “internal control relevant to the audit”, as discussed above.
- After further deliberation, SAICA believes that there may be an issue with the manner in which information system controls (paragraphs 35 to 37), control activities (paragraph 38) and controls relevant to the audit (paragraphs 39 to 42) have been structured:
 - Information system controls and control activities are the two components that comprise direct controls and, by their nature, they are very closely related. For example, the flow of information as part of a particular business process, including how transactions are initiated, recorded,

processed and corrected, will also encapsulate control activities such as authorizations and approvals, reconciliations and verifications.

- It is peculiar why the control activities component is presented and structured in a different manner compared to any of the other four components. Furthermore, why is it necessary to link controls relevant to the audit primarily to the control activities component and not also to information system controls? To illustrate, it would be possible to also identify the controls listed in paragraph 39(a) to (e) with controls in the information system and communication component.
- The interrelatedness of the information system and communication component, and the control activities component is acknowledged in paragraph A160: "Controls in the control activities component include those controls over the flows of information within the information system relating to significant classes of transactions, account balances and disclosures and the financial reporting process used to prepare the financial statements."
- There are further indications of this interrelatedness (for example, paragraphs A166 and 40) and, hence, that it is more appropriate to assert that controls relevant to the audit are primarily controls in the information system and communication, and control activities components (i.e. direct controls).
- We believe that a higher level of clarity would be achieved if the control activities component is presented and structured in the same format as the other components, followed by the "Controls relevant to the audit"-section. The latter should be based on the notion that controls relevant to the audit are primarily identified from the direct controls components, namely the information system and communication, and control activities. It may then also be possible to only address the "design and implementation" requirement once, whereas it is now split between paragraphs 36 and 42 (although some thought would need to go into whether the robustness of the auditor's understanding of an entity's direct controls may be compromised).
- To further clarify our comments above, the structure of the standard under the heading "Components of the Entity's System of Internal Control" (paragraphs 27 to 44) is envisaged as follows (indicating headings only):

Indirect controls

Control Environment

The Entity's Risk Assessment Process

The Entity's Process to Monitor the System of Internal Control

Direct controls

The Information System and Communication

Control Activities

Controls Relevant to the Audit

Control Deficiencies Within the System of Internal Control

- Related revisions to paragraphs 26 and A104 would also be required.

63. SMPC

- We note in our answer to question 2 above, differences of opinion regarding the need for auditors to understand controls where a wholly substantive audit approach is taken. On balance, we agree that some high level understanding of controls, and particularly the controls environment is necessary regardless of the audit approach, but we believe that extent of design and implementation work required under these proposals and the amount of material on controls and IT generally will only reinforce the belief in some quarters that ISAs simply cannot be operationalized efficiently for smaller and less complex audits.
- Subject to these considerations, we support the new material relating to the different characteristics of direct and indirect control components, and the clarifications regarding controls relevant to the audit.
- It could be made clearer that understanding the control environment is an integral part of understanding the entity and identifying and assessing inherent risk the risk of material misstatement, even when the practitioner is undertaking a fully substantive approach to the audit. It is still challenging to assess the extent and depth of work required in this area.
- The application material could clarify the differences in work required for evaluating the control environment (req. 27 & 28), the entity's risk assessment process (req. 29-31) and controls relevant to the audit (req. 39-42), which states each control needs to be evaluated to be designed effectively and that it has been implemented. This difference may be helpful to efficiently perform audits of SMEs.
- The ED outlines that if the auditor does not contemplate testing the operating effectiveness of controls, or is not required to test controls, control risk is assessed at maximum (para. 50 of the ED). The word "maximum", is problematic. It appears to imply a significant problem and an increased risk of material misstatement where in practice, there may be no problem at all. The fact that auditors do not test controls does not make controls weaker, although this is what seems to be implied.
- Requirement 21 states that the auditor shall 'evaluate' whether information from audit procedures performed in previous audits remains relevant and reliable. We are concerned that 'evaluate' implies a higher work effort (e.g. the performance of procedures when necessary), which we do not see as justified. We believe the auditor should be required to apply their mind to the results of procedures that have already been performed, and thus the term "consider" would be more appropriate. In addition, it could be made clearer whether testing results of operating effectiveness of controls from prior periods remain valid upon making assessment of control risks. In addition, we question why "and reliability" has been added as a conforming change to ISA 330 para. 14. In our view, audit evidence can lose relevance, but not reliability; so it does not seem logical to include it.

65. Chartered Accountants Academy (Zimbabwe)

The requirements related to the auditor's understanding of each component of the entity's system of internal control have been clarified. Through use of the flow chart, the steps clearly show where exactly the use of IT comes in, in the evaluation and design of controls and implementation. The five components of the system of internal control process have been identified and guidance has been provided in the flow chart.

66. FocusRoi Inc - Canada

Do not disagree with the guidance provided but it will not be liked (or even understood) by auditors of smaller entities who often fail to appreciate the specific audit implications and linkages between an adequate control environment component and the nature and extent of substantive procedures to be performed.

67. Lynessa Dias

Agree.

68. Miguel Fonseca Cortina

- Last year, COSO ERM 2017 was released and renamed the components of the internal control system and extended its new related principles. For example, control environment was changed into Governance and Culture.
- In this way, I want to suggest an alignment of ISA 315 (Revised) with COSO ERM 2017 terminology used in this updating of the internal control framework, in order to speak the same language and facilitate the study of both works.

70. S Dianne Azoor Hughes

Questions 5 – 8:

The approach outlined in the exposure draft draws on a somewhat dated approach to assessing risk and the audit approach does not leverage from the significant progress in risk management practice over the past decade. In particular, an assessment of qualitative materiality can be derived from a review of a company's risk registers. Refer to discussion above.

72. American Accounting Association

ED-315 adds a significant amount to the requirements for evaluating components of an entity's system of internal control, increases clarity in evaluating controls, and provides guidance in the evaluation of controls, all of which will be useful to the auditor in understanding and evaluating an entity's system of internal control relevant to financial reporting. The guidance is also useful in applying an approach consistent with the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control - Integrated Framework* (COSO 2013) as it highlights the importance of management's integrity, ethical values, and operating philosophy (i.e., the control environment).