

ISA 315 (Revised) – Responding to Comments to the Exposure Draft

- IAASB Meeting
- March 12th, 2019

Fiona Campbell

Deputy Chair of the IAASB and Chair
of the ISA 315 Task Force

Exposure Draft
July 2018

Comments due: November 2, 2018

International Standard on Auditing

Proposed International Standard
on Auditing 315 (Revised)

Identifying and Assessing the
Risks of Material Misstatement

and

Proposed Consequential and
Conforming Amendments to
Other ISAs

Responses to ED-315

Overarching concerns:

- Broad concerns about the **complexity** and **length** of the proposed standard; as well as **scalability/proportionality**. Concerns included:
 - Standard too prescriptive/ detailed and over-engineered for SMEs
 - Insufficient scalability
 - Increased length makes it less readable
 - Flow not clear
 - Iterative nature of the standard not clear, some areas noted as being circular
 - Introduction of many new definitions and concepts
 - More clarity needed about nature and extent of work in some areas, particularly understanding the system of internal control

Task Force Action – Overall TF Actions to Address Complexity and Scalability

- Calls from respondents to:
 - Maintain ‘**principles-based**’ standards
 - Use **simpler language** and reduce **overall complexity** within the requirements
 - Maintain **robustness** of requirements
 - Enhance **consistency** of application
- Recognition of complexity and scalability/proportionality concerns → **Focus area for Task Force**
- Alternatives presented for discussion relating to “understanding the system of internal control”
 - Same outcome
 - TF operates under assumption to maintain all extant requirements (robustness) – included in both options
 - Option 1: address concerns and issues by providing further clarity in requirements (Column 3 in Agenda item 4-A)
 - Option 2: largely based on Option 1 requirements, but presented differently (e.g., some detail now in definitions) therefore is shorter (Column 4 in Agenda item 4-A)

Addressing Complexity and Scalability

CAG views:

- More principles-based standards would better support scalability
 - Guides could then be used to help with implementation; also easier to update when needed
 - But caution about making standards too simple for more complex entities
 - Not just about short sentences, it also needs to be clear what the requirement is
- More support from Representatives for Option 2 (Column 4), although some preferred Option 1 (Column 3)
 - Although recognition that moving aspects to definitions may make it more complex to put all the relevant pieces together
- Proposed changes appear to have been focused on complexity, not so much on scalability

Addressing Complexity and Scalability

SMPC views:

- Called for more consideration about complexity and length so support current efforts
- Support for proposed changes to terminology:
 - Remove “sufficient appropriate audit evidence” relating to risk assessment procedures
 - Removal of “more than remote”
- Still concern about WHY the auditor must obtain an understanding of some aspects the system of internal control (e.g., risk assessment process) and need further guidance about minimum controls that need to be understood
- Still concern about D&I relating to certain controls in all cases

Question 1

1. Board members are asked for views about the broad approach to apply an overall response to draft the requirements in a different way as set out in Column 4 of **Agenda Item 4-A** (and as explained in paragraphs 19–33). In particular, members are asked to comment on whether such an approach could be an effective way to address the overarching comments from respondents relating to complexity and scalability/proportionality, and if not, why not?

Alternative 1:	Alternative 2:
Column 3 – Option 1	Column 4 – Option 2



Question 2

2. The IAASB is asked for its views about the manner in which the overall response developed by the Task Force has been applied in Column 4 (Option 2) of Agenda Item 4-A. In particular, the IAASB is asked:
- a) Whether the proposed requirements are presented at the correct level of detail, i.e., is there too little detail or too much detail?
 - b) Whether there are important missing concepts from the requirements due to their presentation in this manner (both overall as well as for individual aspects)?
 - c) Whether the use of definitions is appropriate and should be further explored, and if not, where should the detailed aspects related to understanding the individual components of internal control be presented?
 - d) Whether there are any other matters the Task Force should consider in relation to the requirements presented in Column 4 of Agenda Item 4-A?



Question 3

3. The IAASB is asked whether the Task Force should pursue the presentation approach in Column 3 or Column 4 as it makes proposals to revise ED-315, or whether there is an alternative that should be further explored.



Responses to ED–315

Understanding the Entity’s System of Internal Control – Broad Comments

- Support for retaining ‘direct’ and ‘indirect’ components
- Confusion between paragraphs 25 and 26 in ED-315 regarding “understanding” and “identifying controls relevant to the audit”
- Mixed views about detailed matters added to help understand “what” needed to be understood
- Purpose of obtaining the understanding of the system of internal control still not clear, especially when intend to take a substantive approach to the audit
- Still concerns about some terms used:
 - Controls relevant to the audit
 - Relevant to financial reporting
- Still unclear as to work effort required for various ‘evaluations’ required
- Various inconsistencies noted

Task Force Action – Proposed Revisions to ED-315 (Column 3)

Understanding the Entity's System of Internal Control – Broad Proposed Comments

- Overarching requirement to obtain an understanding of the system of internal control
 - Overall purpose added
 - Deleted paragraph 26 of ED-315 (requirement for D&I remains)
- Terminology changes
 - Controls relevant to the audit
 - Relevant to financial reporting
 - Formality / formalized
- Other changes
 - Simplifying language where possible or clarifying intent
 - Purpose within each component added
 - Consistency between components

Understanding the Entity's System of Internal Control

CAG views:

- Supportive of clarifications regarding evaluations / D&I
- Need more on extent of work required – that is key
- Further emphasize controls when 'substantive procedures alone are not enough' in today's environment

Question 4

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



Responses to ED–315

Understanding the Entity's System of Internal Control–Comments Relating to Individual Components of the System of Internal Control

- Control environment
 - Too detailed – level of formality may not be present in less complex entities
- Entity's process to monitor the system of internal control
 - Should there be an evaluation of this component?
- Information system
 - Confusion as to what is required in this component versus “control activities component”
 - Difference between controls required to be understood in each of these components
 - Identifying controls for significant classes of transactions, account balance and disclosures (SCOTABDs) and interaction when significant SCOTABDs are required to be identified
- Control Activities
 - Confusion whether auditor always required to identify controls relevant to the audit, in particular in less complex audits
 - Concern relating to list of control required to be identified and evaluated
 - Scope of the controls required to be identified “in the auditor's judgment”

Task Force Action – Proposed Revisions to ED-315 (Column 3)

Understanding the System of Internal Control – Proposed Changes within Individual Components

- Individual components restructured
 - Consistency between components
 - Prominence to purpose of understanding
 - Clarity of work
- Stronger distinction between information system and control activities
- Clarifications re D&I
- Control activities
 - Clarification re using ‘professional judgment’ to identify controls

Questions 5 and 6

5. The IAASB is asked for its views about the proposed changes in the individual components of internal control, as presented in Column 3 of **Agenda Item 4-A** (and the Appendix to **Agenda item 4-A**), in relation to:
- a) The control environment as explained in paragraphs 67–69 in Agenda Item 4;
 - b) The entity's risk assessment process and process to monitor the system of internal control as explained in paragraphs 70–71 in Agenda Item 4;
 - c) The information system and communication component as explained in paragraphs 72–76 in Agenda Item 4; and
 - d) The control activities component as explained in paragraphs 77–81 in Agenda Item 4.
6. Are there any other matters relating to understanding the entity's system of internal control that the Task Force should consider as it progresses the changes to ED-315?



Responses to ED–315

Identifying and Assessing the Risks of Material Misstatement–Respondents’ Comments

- Only selected matters for discussion at March Board meeting
 - Balance of issues to be brought for discussion at June 2019 IAASB meeting
- Support for separate assessment of inherent and control risk
- Although support for more focus on risk identification and assessment, various concerns noted relating to introduction of SCOTABDs and ‘relevant assertions’
 - Threshold of ‘reasonable possibility’ and ‘more than remote’
 - Complexity introduced and circularity
 - Appears to be a “drill-down” below the assertion level
- Definition of significant risk
 - Little support for magnitude “OR” likelihood
 - Some concerns about presenting as “close to upper end” of spectrum of inherent risk
- Mixed views on new stand-back and retaining ISA 330 para 18
- Spectrum of inherent risk broadly supported but more guidance needed
- Concern about introduction of “sufficient appropriate audit evidence” for risk assessment procedures

Identifying and Assessing the Risks of Material Misstatement

CAG views:

- Mixed views on:
 - ‘Susceptibility to fraud’ as an inherent risk factor – emphasis should be on fraud, but not necessarily as an IRF
 - ‘Sufficient and appropriate audit evidence’
 - Some Representatives who strongly supported retaining
 - Others had the view it causes confusion
 - Significant risk definition (i.e., changing from “or” to “and”)
- Support to remove ‘more than remote’ from relevant assertions definition

Task Force Action – Proposed Revisions to ED-315

Separate Assessment of Inherent and Control Risk

- Assessments to remain separate
- Clarification that identification is based on inherent risk

Question 7

7. The IAASB is asked for its views about the proposed changes as described in paragraph 90 in Agenda Item 4 and the provided revised drafting.



Task Force Action – Proposed Revisions to ED-315

Introduction of SCOTABDs and Relevant Assertions

- Remove threshold of “more than remote”
- Proposed change to simplify definition of “relevant assertion” to link to identified risk of material misstatement; no change to definition of SCOTABDs.
- Proposal to add application material regarding perceived “drill-down”
- Need further views about clarifying how threshold of “reasonable possibility” can be explained

Question 8

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



Task Force Action – Proposed Revisions to ED-315

Significant Risks

- Change to magnitude “AND” likelihood
- Retain describing significant risks as “close to the upper end”
 - Above change should also help with “close to the upper end,” will also consider how this can be further explained in application material as it’s a matter of the auditor’s professional judgment

Question 9

9. The IAASB is asked for its views on:
- (a) Changing the definition of significant risk as explained in paragraph 111 in Agenda Item 4.
 - (b) Retaining the description of significant risks as being “close to the upper end of the spectrum of inherent risk” but providing further application material to support a more consistent application



Task Force Action – Proposed Revisions to ED-315

Stand-back and ISA 330.18

- On balance, benefits to both stand-backs were noted by respondents – although mixed views were expressed on whether to keep one or the other or both
- Retain both the stand-back and ISA 330.18
 - Simplify the stand-back
- Remove ‘qualitative and quantitative’ used to describe materiality as inherently within the concept of materiality

Question 10

10. The IAASB is asked:

- (a) For its views on retaining both the stand-back in paragraph 52 of ED-315, and paragraph 18 of ISA 330, subject to the changes noted, in light of the responses that have been received.
- (b) Whether it agrees with the removal of 'qualitative' and 'quantitative' in paragraph 18 of ISA 330.
- (c) For views about the redrafted paragraph 52 of ED-315 as illustrated in paragraph 125 in Agenda Item 4.



Task Force Action – Proposed Revisions to ED-315

Spectrum of Inherent Risk

- Sufficient support to retain the concept
- No supporting requirement to be added, but Task Force will consider further application material

Question 11

11. The IAASB is asked for its views on the matters set out in paragraphs 131–133 in Agenda Item 4 with regard to the proposed changes relating to the spectrum of inherent risk.



Task Force Action – Proposed Revisions to ED-315

Sufficient Appropriate Audit Evidence – Risk Assessment Procedures

- Work effort suggested not commensurate with the purpose for performing risk assessment procedures
- Revision proposed to clarify that the procedures need to be appropriate for providing a basis for identifying and assessing risks of material misstatement

Question 12

12. The IAASB is asked for its views on the matters set out in paragraph 137 in Agenda item 4 relating to the Task Force's views regarding sufficient appropriate audit evidence in relation to risk assessment procedures.



Task Force Action—Overall Responses to Address Scalability (Application Material)

- Task Force to consider application material once approach to requirements agreed on
- Proposals to:
 - Address **long, complex paragraphs**
 - **Simplify language** where possible
 - Use **bullet lists** where possible – easier to read
 - **Consistency** across sections where possible
 - Should the guidance be maintained in application material or elsewhere?
 - Distinguishing **separate “scalability” paragraphs**
 - **Distinguish examples** e.g., in a box or indented

Question 13

13. The IAASB is asked for its views on how the Task Force proposes to approach changes to the application material to address issues related to scalability and proportionality, and complexity and understandability, as set out in paragraphs 138–143 of Agenda Item 4. Are there any other suggestions about how this can be done?



The Way Forward

- Depending on outcome of Board discussions
- June 2019 IAASB Meeting:
 - IT matters
 - Other matters not yet addressed
 - Full draft for discussion
- September 2019 IAASB Meeting:
 - Targeted approval



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