



AUASB Board Meeting Summary Paper

AGENDA ITEM NO. **3.4**

Meeting Date: 4 December 2018

Subject: ISA 315 Identifying and Assessing the Risks of Material Misstatement

Date Prepared: 26 November 2018

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Action Required

For Information Purposes Only

Agenda Item Objectives

1. To update and inform the AUASB on the IAASB's ISA 315 Task Force's initial analysis of the responses to ED 315 *Identifying and Assessing the Risks of Material Misstatement* (ED 315), and which points raised in the AUASB's submission on ISA 315 have been addressed as part of the IAASB's ISA 315 Task Force's initial analysis.

Background

2. The AUASB submitted a comment letter to the IAASB on ED 315 on 2 November 2018.
3. The ISA 315 Task Force have prepared a high level initial analysis of the 68 responses they received and will provide an update to the IAASB at its December 10 – 14 meeting. The analysis is summarised in this AUASB board paper – if AUASB wish to review the full presentation please refer to this [Link](#) to the IAASB's website.
4. A more detailed analysis, together with the proposed changes, for each matter will be presented at the March 2019 IAASB meeting.

Matters to Consider

5. Overall summary of feedback:
 - (a) Broad concern about the complexity and length of the proposed standard; as well as scalability.
 - (b) There is support for many individual aspects of the enhanced requirements and application material, although mixed views about some of the changes proposed.

This is consistent with the overall theme of the AUASB's comments.

This document contains preliminary views and/or AUASB Technical Group recommendations to be considered at a meeting of the AUASB, and does not necessarily reflect the final decisions of the AUASB. No responsibility is taken for the results of actions or omissions to act on the basis of reliance on any information contained in this document (including any attachments), or for any errors or omissions in it.

6. The analysis to date of the comments received by the IAASB is at a high level and does not always go into the specific matters in detail.
7. All significant points have been raised by other respondents and are being considered by the IAASB Task Force.
8. Following is a mapping of all matters raised by the AUASB and whether they were raised by other respondents, and the Task Force's views. As this is an initial analysis being conducted by the Task Force, in some many instances they are still under consideration, and there is no indication of how the matters will be addressed.

Matters raised by the AUASB	Summary of feedback and Task Force views
<p><u>Complexity and length of standard</u></p> <ul style="list-style-type: none"> • The increased length of ED 315 is a potential barrier to its understandability and consistent application. • Consider drafting standards for less complex entities, then adding application or guidance for more complex entities. • The introduction of many new definitions and concepts, or the distinction between concepts, add complexity to the standard. • Reassess whether some content currently in the application material of ED 315 should instead be included in other non-authoritative guidance. 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Broad concern about the complexity and length of the proposed standard, and scalability. • Concern over the new definitions and concepts raised by others – except “material” verses “significant”. <p><u>Task force view:</u></p> <ul style="list-style-type: none"> • Application material <ul style="list-style-type: none"> ○ Shortening sentences and paragraphs ○ Use of language that is more understandable ○ What can be moved to appendix / guidance ○ Use of Q & A • New concepts – all being considered however significant vs material – not raised by others <p><u>ATG comment</u></p> <ul style="list-style-type: none"> • <i>All matters raised by the AUASB have been addressed and are being considered, except significant vs material</i>
<p><u>Definition “significant classes of transactions, account balances and disclosures” and “relevant assertions”.</u></p> <p>We consider that the term “more than remote” is fundamentally different to “a reasonable possibility”, and this revised definition may result in more significant classes of transactions, account balances, or disclosures being identified than was intended.</p>	<p><u>Feedback</u></p> <p>Mixed views on this matter.</p> <p><u>Task Force views</u></p> <p>Further considering.</p> <p><u>ATG comment</u></p> <p><i>Point raised by AUASB being considered.</i></p>

<p><u>Inherent risk factors (IRF)</u></p> <ul style="list-style-type: none"> • Supportive of the concepts and definition. But consider it is overly complicated by having a requirement to explicitly take into account IRF. • Insufficient clarity in how to apply the concepts and definitions of the IRF and the current proposed definition of significant risk. • Inclusion of quantitative is potentially problematic. 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Broadly supported. • Further clarification needed regarding interaction between the IRFs. • Mixed views about including quantitative. • Some concern about including susceptibility to fraud as an IRF. • Limited suggestions to require determining IRFs in risk assessment process. <p><u>Task Force views</u></p> <p>Considering:</p> <ul style="list-style-type: none"> • No specific requirement for determining IRFs. • How fraud is addressed and whether to keep as an IRF. • Clarify how IRFs interact. <p><u>ATG Comment</u></p> <p><i>Points raised by AUASB being considered. Note the point in relation to fraud was not raised as an issue by the AUASB.</i></p>
<p><u>Definition of significant risk and the spectrum of inherent risk</u></p> <ul style="list-style-type: none"> • More detail required on the spectrum of inherent risk i.e. how to assess where on the spectrum a risk resides • Definition of significant risk should be “likelihood <u>and</u> magnitude” as opposed to the current “likelihood <u>or</u> magnitude”. • The definition of significant risk should be amended to those “at the upper end of the spectrum of inherent risk” and not “close to the upper end of the spectrum of inherent risk”. 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Suggestions for clarification related to the spectrum of inherent risk including needs further explaining in the introductory paragraphs and the standard. • Do you need both spectrum of IR and significant risks? • Articulation of where a risk may fall on the spectrum of IR • Close to the upper end needs further clarification. • Mixed views but on balance support for magnitude and likelihood. <p><u>Task Force views</u></p> <p>Further considering.</p> <p><u>ATG comment</u></p> <p><i>Points raised by AUASB being considered.</i></p>

<p><u>Flowcharts</u></p> <ul style="list-style-type: none"> • Supportive of being in appendices • Suggest they could be further enhanced to better present and emphasise the iterative and non-linear processes contained within the proposed standard 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Broad support for keeping flowcharts – however was noted that they are needed due to the complexity. • Mixed views as to where ie. in standard or elsewhere as guidance. <p><u>Task Force view</u></p> <ul style="list-style-type: none"> • Keep however not enough support for including in standard so considering where these can be presented. <p><u>ATG Comment</u></p> <p><i>Location of flowcharts will be considered by the AUASB when adopting the standard in Australia.</i></p>
<p><u>Introductory paragraphs</u></p> <ul style="list-style-type: none"> • Supportive • Paragraphs 4 and 5 – repetitive • The “spectrum of inherent risk” needs to be described in greater detail by including how a practitioner may assess at which point a risk resides on the spectrum, or alternatively referring to where this concept is specifically explained in the application material. 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Broadly supported with some suggestions for changes. • Spectrum of risk - it needs to be better articulated in the standard <p><u>Task Force view</u></p> <p>Points raised being considered.</p> <p><u>ATG comment</u></p> <p><i>Points raised by AUASB being considered.</i></p>

<p><u>Scalability</u></p> <ul style="list-style-type: none"> • Overall concern ED 315 is not scalable to smaller and medium entities. • Terminology used in ED 315 should refer to “less complex entities”. • Recommend guidance and examples be included in the application material of the proposed standard on how to effectively scale the work effort in ED 315 to less complex entities, such as examples of: how to perform risk identification and assessment procedures for a less complex entity where a mainly substantive audit approach will be adopted; and how to perform risk identification and assessment procedures when the entity’s system of internal control may be less detailed and formalised. 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Broad concern about scalability. • Consider examples of scaling up, and down. <p><u>Task Force views</u></p> <ul style="list-style-type: none"> • For all areas where we do have scalability for ‘simple’ add an example for more complex. • Considering whether to revert to separate paragraphs for scalability or how this can be better signposted in the standard. • Reconsidering documentation requirements. <p><u>ATG comments</u></p> <ul style="list-style-type: none"> • <i>No mention of more examples for smaller and less complex entities</i> • <i>Term “smaller and less complex” was not raised by others</i>
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<p><u>Automated tools and techniques</u></p> <ul style="list-style-type: none"> • Agree with the approach taken of using examples to illustrate how automated tools and techniques may be used in risk assessment. • ED 315 could be further enhanced by addressing: <ul style="list-style-type: none"> ○ How automated tools and techniques may be used for risk assessment, and how they meet or impact the requirements of ED 315. This is to avoid automated tools and techniques being applied in addition to the current requirements. ○ What are the requirements in relation to understanding and/or obtaining evidence over the reliability of underlying data (information produced by the entity) used within automated tools and techniques that are used for risk assessment (including the nature, timing and extent of testing). ○ Risk factors relating to the use of big data and automated analytics technology. • Other specific suggestions raised 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Broad support for enhancements • Further suggestions related to matters outside the scope of ED 315 ie. ISA 500 • Limited suggestions to require use of DA <p><u>Task Force views</u></p> <ul style="list-style-type: none"> • Clarify that usage automates risk assessment, not supplemental • Coordinate with DAWG in relation to non-ISA 315 aspect • Possible FAQs <p><u>ATG Comment</u></p> <p><i>Most points raised by the AUASB being considered except in relation to underlying data, and the specific suggestions raised however these were suggestions for improvement and not major points.</i></p>
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<p><u>Professional scepticism</u></p> <ul style="list-style-type: none"> • Supportive of the principle of obtaining an appropriate base of evidence for risk assessment, however we do not support using the term “sufficient appropriate audit evidence” • Suggested further enhancements 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Largely supportive. • Consider to consider different sources of evidence for contradictory information. • Consider further how to guide documentation. • Mixed views on the term “sufficient appropriate audit evidence”. <p><u>Task Force views</u></p> <ul style="list-style-type: none"> • Relook at concept of “sufficient appropriate audit evidence” and considering “provide an appropriate basis”. • Not enough detail provided on whether the enhancements we suggested are being considered. <p><u>ATG comment</u></p> <p><i>Points raised by AUASB being considered.</i></p>
<p><u>Internal controls</u></p> <ul style="list-style-type: none"> • It is not sufficiently clear how controls including the understanding obtained over the system of internal control, impact the identification of risks of material misstatement. • Clarify the design and implementation testing required verses gaining an understanding. • 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. • Controls relevant to the audit – clarify the intention of 39(e). • Some of our stakeholders have expressed concern that for some less complex entities the controls over journals may not be documented and are difficult to test. 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • All points raised by others <p><u>Task Force views</u></p> <ul style="list-style-type: none"> • Considering guidance to explain WHY doing various aspects - make the links to why certain procedures are required • Clarify how control activities are different from other components, especially the information system • Clarify concept of Information System controls relevant to financial reporting • Further consider controls relevant to the audit including those designated that are in the auditor’s judgement; journal entries <p><u>ATG Comment</u></p> <p><i>It is not clear as to whether the first point raised by the AUASB is being addressed. Other points raised being addressed.</i></p>

<p><u>Information Technology</u></p> <ul style="list-style-type: none"> • Support the introduction of the new IT-related concepts and definitions. • Could be enhanced by including the risk factors relating to current and evolving technology which connect to organizational networks, such as infrastructure / software as a service solutions, wireless networks, blockchain, and other technology devices that connect to organisational networks. 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Broadly supportive. • Various suggestions for enhancements (not detailed) <p><u>Task Force view</u></p> <ul style="list-style-type: none"> • Considering the suggested enhancements. • Considering moving some of the application material to appendix. <p><u>ATG Comments</u></p> <p><i>It is not clear if the point raised by the AUASB is being addressed however this was a matter to enhance and not a major point.</i></p>
<p><u>Separate inherent and control risk assessment</u></p> <ul style="list-style-type: none"> • Support the separate assessments of inherent and control risk at the assertion level. • Support assessing control risk at maximum if not testing operating effectiveness. • The current use of the singular term (“risks of material misstatement”) both before and after the separate assessment of inherent risk and control risk is confusing. • Provide additional detail on how to assess control risk at various levels of the spectrum of risk. • Describing in greater granularity in ED 315 the process the auditor undertakes to combine their separate inherent and control risk assessments. 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Significant support for the separate assessments. • Confusion about how the separate assessments are related to identified and assessed risks of material misstatement. • Concern about assessing control risk based on D & I and presumed expectation of control risk at maximum unless intent to test operating effectiveness of controls. <p><u>Task Force views</u></p> <ul style="list-style-type: none"> • Leave separate but further consideration as to how each assessment is articulated • Clarify how separate assessments are related to identified and assessed risks of material misstatement. • Clarify D & I and how it impacts control risk assessment • Clarify “expected” operating effectiveness of controls to reduce control risk from maximum. <p><u>ATG comment</u></p> <p><i>Points raised by AUASB being considered.</i></p>

<p><u>Financial Statement Risks</u></p> <ul style="list-style-type: none"> • Supportive however need clarity / examples of how they may affect the assessment of risks at the assertion level. • Include in introductory paragraphs 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Broadly supportive • More guidance needed about how impacts assertion level risks. <p><u>Task Force views</u></p> <ul style="list-style-type: none"> • Include more on impact on assertion level risks. <p><i>ATG comment</i></p> <p><i>Points raised by AUASB being considered.</i></p>
<p><u>Stand back and ISA 330 para 18</u></p> <ul style="list-style-type: none"> • Supportive of a standback in 315 but don't need both • Reconsider if the terms "quantitatively and qualitatively" are necessary in ISA 315 	<p><u>Feedback</u></p> <ul style="list-style-type: none"> • Mixed views ie. support for keeping both, as well as either • Questions whether needed either? • Some concern about including qualitatively in ISA 330. <p><u>Task Force views</u></p> <ul style="list-style-type: none"> • On balance keep both • Delete qualitative from 330.18 <p><i>ATG Comments</i></p> <p><i>The AUASB received mixed feedback on where the stand back provision should be, and on balance preferred it in 315.</i></p> <p><i>If the terms "quantitatively and qualitatively" are maintained in 315, it will potentially result in more significant classes of transactions, account balances and disclosures, and will further reduce the impact of the stand back in 330.</i></p>

9. Other matters raised by the AUASB and not included in the IAASB summary

The AUASB's submission included that the public sector considerations had not been appropriately considered. If this is not addressed in the final standard, the AUASB can consider if additional Australian guidance is required.

AUASB Technical Group Recommendations

10. N/A. For the AUASB's information only.

Material Presented

Agenda Item

3.4.1 ED315 AUASB Board Meeting Summary Paper