



AUASB Board Meeting Summary Paper

AGENDA ITEM NO. **2.1.0**

Meeting Date: 12 June 2019

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

Date Prepared: 5 June 2019

Prepared by: Anne Waters – AUASB Senior Project Manager

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 proposed changes to respond to ED 315 *Identifying and Assessing the Risks of Material Misstatement* (ED 315), which is being presented at the June 2019 IAASB meeting;
2. To communicate to the AUASB how the matters raised in our submission on ISA 315 are being addressed; and
3. For the AUASB to provide views on the proposed changes contained in redrafted ISA 315 to AUASB Chair Roger Simnett in his capacity as an IAASB member.

Background

4. The AUASB submitted a comment letter to the IAASB on ED 315 on 2 November 2018.
5. For the March 2019 IAASB Meeting the IAASB considered a detailed analysis of the 72 responses the IAASB received on ED 315 prepared by the ISA 315 Task Force, as well as agreed a new drafting style or approach to reduce the length and complexity of the requirements. Based on the feedback by the IAASB the ISA 315 Task Force have progressed changes to ISA 315 by focusing its efforts on implementing the new drafting style or approach, and the requirements.
6. The agenda item presented for discussion provides a substantially complete proposed revised standard with application material and appendices still to be finalised. Also the Introductory paragraphs and the automated tools and techniques content have not been finalised.
7. An analysis of the IAASB's Issues paper and proposals is summarised in this AUASB board paper – if AUASB members wish to review the full suite of materials relating to this IAASB Agenda Item refer to the [IAASB's](#) website (Refer IAASB 'Agenda Item 2 - ISA 315 (Revised)').

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.

Matters to Consider

Drafting style

8. The main theme throughout the responses to ED 315 was related to its complexity, as well as scalability and proportionality. There were also many comments related to individual aspects of the proposals, some supporting the specific changes that had been proposed, while other comments highlighted concerns or disagreement.
9. The ISA 315 Task Force have redrafted the requirements based on the new drafting approach. The requirements are the “what”, the application material, appendices and guidance is the “why” and “how”. There is substantial use of definitions to remove content from the requirements whilst maintaining the rigor of the requirements. As such, the requirements need to be considered with the supporting definitions. This is to achieve the objective of making the standard less complex, shorter and more understandable.
10. The ISA 315 Task Force have been considering whether moving content from the requirements to the definitions impacts the robustness of the ISA, and whether changes may be needed to ISA 200 to enhance the “authority” of the definitions? The IAASB are asked to consider this.
11. The phrase ‘relevant aspects’ has been introduced to the requirements to obtain an understanding of the entity and its environment, the applicable financial reporting framework and the entity’s system of internal control, highlighting that particular matters need to be understood to support the identification and assessment of the risks of material misstatement. The definitions include the detail on the components that make up the relevant aspects. For example paragraph 17 and 23 in redrafted ISA 315.

Redrafted ISA 315

12. The AUASB Technical Group (ATG) have reconciled the matters raised by the AUASB in the submission to the IAASB on ED 315, and how they have been addressed in redrafted ISA 315. Refer to the table below. Based on this the ATG have raised additional questions for the AUASB’s consideration.
13. As a result of the new drafting style and in efforts to simplify the standard Redrafted ISA 315 consists of 4 pages of definitions (2 in ED), 5 pages requirements (8 in ED), and 54 pages application material (60 in ED). The application material is still being re-ordered and drafted with some material likely to move to the appendices.
14. Redrafted ISA 315 includes:
 - Appendix 1: Considerations for Understanding the Entity and its Business Model
 - Appendix 2: Understanding the Inherent Risk Factors
 - Appendix 3: Understanding the Entity’s System of Internal Control
 - Appendix 4: Considerations for Understanding Internal Audit
 - Appendix 5: Considerations for Understanding Information Technology
 - Appendix 6: Considerations for Understanding General IT Controls
 - Flowcharts – updated for the new requirements
15. The ISA 315 Task Force are also developing guidance to assist with implementation:

- First time implementation guide – new and revised concepts
- Frequently asked questions

Actions for the AUASB

1. Review Table 1 (below) and consider if you agree with how matters raised in our submission have been addressed. Consider the questions included in this table shaded in grey.
2. Read redrafted ISA 315 (ISA 315 Full standard revised clean) – definitions and requirements. Application material has been provided to assist however note this has not been finalised. Consider:
 - (a) Do you think the new drafting style assists with the complexity and overall understandability of the standard?
 - (b) Do you have any concerns in relation to moving content from the requirements to the definitions and if this decreases the robustness of the standard?
 - (c) Do you agree with the requirements?
 - (d) Do you have any other matters to raise?

Table 1: Reconciliation of the AUASB submission to the updated ISA 315

Matters raised in the ED 315 submission by the AUASB	How the matters are addressed in redrafted ISA 315
<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>Addressed through new drafting style as well as simplifying requirements and removing set up or sign post requirements.</p>
<p>Definition “significant classes of transactions, account balances and disclosures” and “relevant assertions”.</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>	<ul style="list-style-type: none"> • Concern has been addressed the definitions are now: <ul style="list-style-type: none"> ○ Significant class of transaction, account balance or disclosure – A class of transactions, account balance or disclosure for which there is one or more relevant assertion. ○ Relevant assertions – An assertion about a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement. The determination of whether an assertion is a relevant assertion is made before consideration of controls.” • The ED 315 Task Force have been considering how to link the threshold to an identified risk of material misstatement to a concept already existing in the ISAs, and have proposed the following amendment to ISA 200: <p><u>New Definitions: Risk of Material Misstatement (Ref: Para. 13(n)) A15a.</u></p> <p><u>In determining identified risks of material misstatement, the auditor considers those risks for which a misstatement could be material, and the likelihood that the risk could occur (i.e., whether there is a reasonable possibility that the risk could occur). If there are risks that could result in a material misstatement and have a reasonable possibility of occurrence and that have not been addressed by the auditor’s procedures, then audit risk is not at an acceptably low level. The auditor’s</u></p>

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	<p><u>judgment is necessary to identify which risks are identified risks of material.</u></p> <div style="border: 1px solid black; padding: 5px; margin: 10px 0;"> <p>Question for the AUASB</p> <p>Does the AUASB agree with this proposed amendment to ISA 200?</p> </div>
<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>Matters partly addressed. Appendix 2 Understanding the IRF has been developed for inclusion in ISA 315 to assist.</p> <ul style="list-style-type: none"> • IRF are now included in the required understanding of the entity and its environment, because it is at this stage that the auditor will consider the events and conditions to which the inherent risk factors relate. (paragraph 23) The related application material has also been enhanced to explain how the inherent risk factors are considered when the auditor obtains an understanding about how the applicable financial reporting framework is applied, giving rise to the auditor’s understanding about whether classes of transactions, account balances or disclosures are subject to, or affected by, the inherent risk factors • IRF maintained in the requirement to assess inherent risk, and definition of significant risk. • Definition of IRF still includes “quantitative” however as the definition of significant has been changed from “likelihood or magnitude” to likelihood and magnitude”, this is no longer problematic.
<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>Matters partly addressed however more explanatory and appendix to assist with concepts.</p> <ul style="list-style-type: none"> • Concept of spectrum of inherent risk is retained and guidance on how to assess where on the spectrum a risk would reside with illustrations. • Changed the definition of significant risk to “likelihood of misstatement occurring <u>and</u> the magnitude of potential misstatement”. • Definition of significant risk retained as “close to the upper end of the spectrum of inherent risk” • Cautious about adding too much application material on how to assess on the spectrum as this requires professional judgement. Will add application material to clarify that: <ul style="list-style-type: none"> • in rare circumstances there may be an entity that does not have a significant risk • routine, non-complex transactions are not likely to give risk to significant risk when they do not involve subjectivity (eg

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	<p>trade receivables unlikely to be a SR but the valuation could be).</p> <p>In summary the AUASB’s concerns have been considered and addressed except for the third point as the “close to” is proposed to be retained.</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>Have been simplified based on the updated standard. Will be in appendices.</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><i>Still to be updated. To be reviewed by the AUASB at its September 2019 meeting.</i></p>

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<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>A main focus of the Task Force.</p> <p>Terminology has been changed and the application material includes “Scalability paragraphs”</p>
<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	<p><i>Still to be updated. To be reviewed by the AUASB at its September 2019 meeting..</i></p>

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<p>applied in addition to the current requirements.</p> <ul style="list-style-type: none"> ○ 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>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” 	<p>Matter addressed. The term “sufficient appropriate audit evidence” has been removed and the following requirements (underlined) added specifically to address:</p> <p>(17) The auditor shall <u>design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for: (a) The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels; and (b) The design of further audit procedures in accordance with ISA 330.</u></p> <p>[New] <u>The auditor shall design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory.</u></p> <p>[New] 51A. <u>The auditor shall evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement at the financial statement and assertion level, and the design of further audit procedures. In identifying and assessing the risks of material misstatement, the auditor shall take</u></p>

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	<p><u>into account all audit evidence relevant to risk assessment procedures, whether corroborative or contradictory</u></p> <p>The following has been removed from requirements and added to application material:</p> <p>Inquiry alone is not sufficient for this purpose. Risk assessment procedures by themselves do not provide sufficient appropriate audit evidence on which to base the audit opinion. This has been moved to application material – see paragraph A141c.</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>The ATG consider these points have been addressed and updated ISA 315 much clearer. Refer to question below</p> <ul style="list-style-type: none"> • The requirement to ‘obtain an understanding’ of each component of internal control has been deleted. Rather, a broad requirement to obtain an understanding of the relevant aspects of the components of the entity’s system of internal control has been combined with the requirement to obtain an understanding of the entity and its environment, and the applicable financial reporting framework/ Application material explains that the understanding is obtained by focusing on the relevant aspects of each component, with the relevant aspects that are required to be understood for each component now in the definitions. • The evaluations for each of the components have been kept separate (however, the entity’s process to monitor the system of internal control and the entity’s risk assessment process have been combined as they are similar in nature). Application material has been added to make clear that the broader term “understanding” means to obtain an understanding of the relevant aspects of that component (implicitly referring to the definition which contains the ‘relevant aspects’ to be understood) AND to perform the evaluation of the component as set out in each section. It is this ‘understanding’ that provides the basis for the identification and assessment of the risks of material misstatement. • The evaluation of the information system and communication component has been amended to distinguish this evaluation from that required from the evaluation required for controls in the control activities component (i.e., evaluating whether the policies that define information processing activities in the entity’s information system appropriately support the preparation of the financial statements versus evaluating whether identified controls in the control activities component are designed effectively and determining their implementation (D&I)). • The requirement for D&I has been simplified to apply to the identified controls in the control activities component,

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	<p>including GITCs, so that it is clear for which controls D&I is required.</p> <ul style="list-style-type: none"> Paragraph 39 Controls relevant to the audit have contained to “the control activities component”. Paragraph 39 e in ED 315 has been changed to paragraph 39 c to: <p>Controls that are necessary for the auditor to identify to achieve the objectives in paragraph 17(a) and (b) because of where the assessments of the related risks of material misstatement at the assertion level fall on the spectrum of inherent risk;</p> <div style="border: 1px solid black; padding: 5px; margin: 10px 0;"> <p>Question for the AUASB</p> <p>Do you agree with the change to paragraph 39, specifically 39 c – is it clear what would be captured here?</p> </div>
<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>Have modernised and added new definitions. Redrafted ISA 315 paragraph 40 requires the identification of the risks arising from IT and defined below.</p> <p><i>[New] Risks arising from IT</i> – Susceptibility of information processing controls to ineffective design or operation, or risks to the integrity of the entity’s information in the entity’s information system, due to the ineffective design or operation of the entity’s IT processes (see IT environment).</p> <p><i>General IT controls</i>- Control activities that support the continued proper operation of the IT environment, including the continued effective functioning of information processing controls and the integrity of information (i.e. the completeness, accuracy and validity of information) in the entity’s information system. General IT controls are controls over the entity’s IT processes. Also see the definition of IT environment.</p> <p><i>Information processing controls</i> (new term for application controls) - Control activities that directly support the actions to mitigate transactions and information processing risks in the entity’s information system. They may operate at the assertion level or may support the operation of other control activities at the assertion level. The objectives of information processing controls are to maintain the completeness, accuracy and validity of transactions and other information throughout processing. Such controls may be automated or manual and may rely on information or other controls, including other information processing controls that maintain the integrity of information.</p>

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<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. 	<ul style="list-style-type: none"> • The requirement to identify risks of material misstatement has been simplified to make clear what needs to be identified and removing the “how.” • The identification and assessment of ROMM has been simplified and doesn’t include the how. • The order for determining the relevant assertions and significant classes of transactions, account balances and disclosures has been reversed and is after the identification of ROMM • The inherent risk factors have been deleted from the identification of the risks of material misstatement at the assertion level, and only presented as part of the assessment of the risks of material misstatement at the assertion level, • To address the concerns about assessing control risk at maximum when the auditor has no intention to test the operating effectiveness of controls, the Task Force has proposed that the requirement to assess control risk is conditional on the auditor’s intent to test the operating effectiveness of controls. If there is no such intention, the assessment of the risks of material misstatement is based on inherent risk (i.e., control risk is not taken into account). This would therefore eliminate the need to assess control risk at the “maximum.” The related application material has been amended accordingly.
<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>Not addressed at this stage</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>The stand back provision retained in both 315 and 330. The references to qualitative and quantitative in the context of materiality have removed.</p> <p>ED 315 Paragraph 53 proposed to read:</p> <p>For material classes of transactions, account balances or disclosures that have not been identified as significant classes of transactions, account balances or disclosures the auditor shall evaluate whether the auditor’s conclusion that there are no related risks of material misstatement remains appropriate.</p>

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	330 para 18 to remain as it is and application material to make it clear that the auditor would consider the most appropriate assertion when designing substantive audit procedures.		
	<table border="1"> <tr> <td>Question for the IAASB</td> </tr> <tr> <td>Do you agree with paragraph 53?</td> </tr> </table>	Question for the IAASB	Do you agree with paragraph 53?
Question for the IAASB			
Do you agree with paragraph 53?			

16. 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. The public sector matters have not been updated in the

Material Presented

Agenda Item 2.1.0

ED 315 AUASB Board Meeting Summary Paper

Agenda Item 2.1.1

IAASB ED 315 Agenda Item 2F – ISA 315 Full standard revised clean