

IAASB Project – ISA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

AUASB Technical Group Feedback to the AUASB for discussion at its meeting on 7 March 2018

Project Objective	AUASB SMEs
<p>The objectives of the project are to:</p> <p>(a) Propose revisions to ISA 315 (Revised), establishing more robust requirements and appropriately detailed guidance to drive auditors to perform appropriate risk assessment procedures in a manner commensurate with the size and nature of the entity. It is anticipated that these revisions will focus on enhancing the auditor’s approach to understanding the entity, its environment (including its internal control) and risk assessment activities in light of the changing environment.</p> <p>(b) Determine whether and how ISA 315 (Revised), in its organization and structure, can be modified to promote a more effective risk assessment.</p> <p>(c) Propose consequential amendments to other standards that may be necessary as a result of revisions to ISA 315 (Revised) (such as ISA 220, ISA 240, ISA 330 ISA 540 and ISA 600).</p> <p>(d) Determine what non-authoritative guidance and support tools should be developed by the IAASB, or others, to supplement revisions to ISA 315 (Revised) thereby aiding its effective implementation. Non-authoritative guidance and support tools may include International Auditing Practice Notes (IAPNs), Staff publications, project updates, or illustrations / examples to provide assistance on how ISA 315 (Revised) could be applied, in particular to address concerns by auditors of SMEs.</p>	<p>Justin Reid / Anne Waters</p>
<p>Background and overall comments:</p> <ul style="list-style-type: none"> • The ISA 315 Task Force are presenting the second draft of the proposed amendments to ISA 315 at the IAASB March 2018 meeting. • The IAASB broadly supported the proposals in the first draft discussed at its meeting in December 2017 and asked for further consideration on various matters including: <ul style="list-style-type: none"> ○ definitions of “controls” and “relevant assertions” ○ the introduction of the term “business model” and its interactions with current requirements of the standard ○ the use of “sufficient and appropriate” as it relates to potential confusion with “sufficient appropriate audit evidence” ○ further consideration of how fraud can be included as qualitative inherent risk factor, and the link to ISA 240 ○ spectrum of risk could be better explained earlier in the standard. 	

- The AUASB have been monitoring the development of the proposed amendments to ISA 315, and at its teleconference on 5 December 2017 discussed that based on the review of the papers being discussed at the December 2017 IAASB meeting:
 - There were no significant concerns with the status or direction of ISA 315
 - The impact of application for SME's, Data Analytics and Public Sector is still being determined and will be presented at the March 2018 IAASB meeting.
 - The ISA 315 taskforce has separated the 'understanding' required from the identification of 'controls relevant to the audit,' as some components may not necessarily have 'controls relevant to the audit', which has been clarified to be those controls that meet certain criteria outlined in paragraph 21 (e.g. that are relevant to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; that are relevant to a significant risk; are over journal entries; etc).
 - The requirements to identify and assess the risks of material misstatement, including inherent and control risks, including the introduction of the concept of a 'spectrum of inherent risk' have been made clearer.

AUASB Key Points from review of March 2018 IAASB papers

Overall comments

- There are extensive redrafting and restructuring changes to the proposed standard as a result of the comments received. The Task Force has provided an extensive analysis of all the changes since the previous version and the rationale for decisions made to assist the IAASB with its consideration of the draft standard.
- Whilst no concerns with the overall direction of the standard there are a few matters highlighted below: The following is a summary of the changes and matters to discuss with the AUASB:
 - New introductory paragraphs to provide context and the interaction with ISA 200 and ISA 330 have been added which are a good addition.
 - Changes to and new definitions ie. controls, general IT controls and application controls relevant asserts, significant risks.
 - ◆ Qualitative Inherent Risk Factors changed to Inherent Risk Factors (IRF). IRF now incorporates qualitative and quantitative factors before consideration of controls. Impact is that IRF now includes the size of the class of transaction, account balance or disclosure relative to performance materiality.
 - ◆ Within the definition of IRF, fraud is now replaced with management bias as the Task Force believe this is consistent with the concept of IRF.
 - ◆ New definition of reasonable possibility raises a concern that low risk material balances may become significant which will increase work effort where not considered necessary.
 - ◇ Significant class of transaction, account balance or disclosure is where there is a relevant assertion. Definition of relevant assertions is when there is a reasonable possibility of a material misstatement. Reasonable possibility defined as where the likelihood of a material misstatement is more than remote. Remote is lower than reasonable.
 - ◆ Definitions of class of transaction and account balances as there is a risk auditors

will disaggregate items.

- The Task Force have redrafted and re-ordered requirements and related application material. There are no significant issues except refer new requirement 30A for discussion:
 - ◆ Restructured the requirements under a new section that addresses “Controls Relevant to the Audit”.
 - ◆ Includes requirements related to dealing with any identified deficiencies consistent with ISA 265 and 330.
 - ◆ Introducing a requirement in paragraph 18A to evaluate the design of the information system and to determine if it has been placed into operation. This is distinct from the evaluation of individual controls over the information system required by paragraph 21B.
 - ◆ Restructured and clarification of requirements relevant to IT including reinstated requirement for the identification of risk arising from IT (paragraph 21). The requirements relevant to IT raise no concerns however are still being refined including and application material is still being drafted.
 - ◆ Identifying and Assessing the Risks of Material Misstatement – clarified that when the operating effectiveness of controls are not tested the auditor shall assess controls risk at the maximum.
 - ◆ Added a new requirement (30A) in relation to classes of transactions, account balances and disclosures that are not significant, but are quantitatively or qualitatively material. Is this necessary given the existing requirement in ASA 330 paragraph 18? The Task Force have added this to ISA 315 to require auditors to consider the risk of the item, not just the size. Also the Task Force recommend that ASA 330 paragraph 18 is amended to:

Irrespective of the assessed risk of material misstatement, the auditor shall design and perform substantive procedures for each class of transactions, account balance and disclosure that is quantitatively or qualitatively material.
 - ◆ Additional application material to assist with scalability. Principle is that scalability applies to all sized entities and the important factor is complexity. The Task Force plan to add more to the application material.
 - ◆ Some application material on how “automated tools and techniques” ie. data analytics are used in the risk assessment process is included however the ISA 315 Task Force plans to continue working with the DAWG to further enhance this prior to June.
 - ◆ Appendices:
 - ◇ 1. *Considerations for understanding the Entity and its Business Model* – New appendix but content was in application material in the December version.
 - ◇ 2. *Events and Conditions That May Indicate Risk of Material Misstatement* - Is in the extant but has been expanded.
 - ◇ *Understanding the Entity’s System of Internal Control* – appendix 1 in

extant and has been updated.

Next steps / still to be completed

- The following is still in development:
 - the application material relating to public sector will be updated after planned outreach in March 2018.
 - the scalability of the standard as it further refines the proposed changes.
 - the application material related to information technology considerations as well as general IT controls.
 - further consideration of automated tools and techniques ie. data analytics however likely to require further amendments.
- Conforming amendments will be presented at the June 2018 IAASB meeting, except for those relating to ISA 330 paragraph 18 which are included in agenda item 3.
- The ISA 315 and 540 Task Forces are working together as both projects progress and to minimise conforming amendments.

AUASB influencing activities

AUASB Technical Director to prepare briefing notes for distribution to Australasian IAASB members and AUASB Chair.

Next steps / milestones for this project

- The Task Force are planning on presenting a draft ED for approval at the June 2018 IAASB meeting.