



AUASB Board Meeting Summary Paper

AGENDA ITEM NO. **7.1.0**

Meeting Date: 6 March 2019

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

Date Prepared: 28 February 2019

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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 detailed analysis of the responses to ED 315 *Identifying and Assessing the Risks of Material Misstatement* (ED 315), and how they propose to address, which is being presented at the March 2019 IAASB meeting;
2. To communicate to the AUASB how the matters raised in our submission on ISA 315 are being addressed as part of the IAASB’s ISA 315 Task Force’s analysis; and
3. For the AUASB to provide views on the proposed responses to ED 315 to 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 ISA 315 Task Force have prepared a detailed analysis of the 72 responses the IAASB received on ED 315 and have summarised these into Agenda item 4 ISA 315 (Revised) – Issues and Recommendations (IAASB Issues paper).
6. The analysis of the IAASB’s Issues paper and how the ED 315 Task Force is proposing to address is summarised in this AUASB board paper – if AUASB members wish to review the full suite of materials relating to this IAASB Agenda Item please refer to this [Link](#) to the IAASB’s website (Refer IAASB ‘Agenda Item 4 - ISA 315 (Revised)’).

Matters to Consider

7. The main theme throughout the responses to ED 315 related to the complexity of the proposals, as well as the scalability and proportionality of the proposed standard. There were also many comments

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related to individual aspects of the proposals, some supporting the specific changes that had been proposed, while other comments highlighted concerns or disagreement.

8. Not all aspects of the feedback has been addressed yet by the ISA 315 Task Force, including all matters related to Information Technology which will be discussed by the IAASB at its June 2019 meeting. The ISA 315 Task Force have focused on the broad concerns related to complexity and scalability, and feedback on individual key requirements. The ISA 315 Task Force are asking the IAASB to deliberate on the main issues raised by respondents at the March meeting to allow them to complete drafting of the revised ISA 315.
9. The application material is still being re-drafted and will not be considered by the IAASB at the March meeting.
10. This paper includes these main issues for the AUASB to consider and provide input to Roger Simnett in his capacity as an IAASB member.

Overarching issues relating to complexity and scalability / proportionality

11. Strong feedback that the proposed changes including the length of the proposed standard introduce a level of complexity which makes it difficult to understand and apply. Scalability a major issue.
12. The ED 315 Task Force are considering how to address including exploring different drafting techniques. Focus is on using simpler language, rewriting requirements to increase understandability, requirements to focus on What and Why, with the How to be in the application material and appendices, reconsidering the application material and appendices.
13. To “test” this they have re-drafted requirements for the “understanding the entity’s system of internal control” section of ED 315 using two drafting styles. Option 1 is the recommended content and is all in the requirements. Option 2 includes more detail in the definitions and reduces the length of the requirement. The intention is the presentation of the requirements looks different but the outcome is the same.
14. The ED 315 Task Force are asking the IAASB for their views at the March 2019 meeting on which is the preferred drafting style before applying to the whole standard.

Action for the AUASB

Refer to the IAASB ED 315 Agenda Paper 4A – Table of Drafting at **Agenda Item 7.1.1**, specifically Column 3 / Option 1 and Column 4 / Option 4. This provides an example of the two drafting styles the IAASB ISA 315 Task Force are evaluating.

What is your preferred drafting style?

15. The application material will also be extensively redrafted to address these concerns. The ED 315 Task Force are proposing to include “Scalability paragraphs”.

Issues raised by the AUASB in its submission on ED 315 and how they are being addressed

16. The following table lays out a mapping of all matters raised by the AUASB in our ED 315 submission to the IAASB, and addresses:
 - (a) Whether these matters were also raised by other respondents, and
 - (b) How the ED 315 Task Force has recommended to the IAASB the feedback on each of these matters should be addressed.

- (c) Questions for the AUASB to consider in order to provide feedback to Roger in his capacity as an IAASB member.

Matters raised in the ED 315 submission by the AUASB	How the ISA 315 Task Force has (or has not) address the AUASB's feedback
<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. 	<ul style="list-style-type: none"> • Consistent significant concern from stakeholders. • The ED 315 Task Force is focusing on addressing these concerns throughout the proposed standard.

Matters raised in the ED 315 submission by the AUASB	How the ISA 315 Task Force has (or has not) address the AUASB's feedback
<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>Overall support for introduction of the concepts. However consistent feedback that the definition of relevant assertion is not right as the term “reasonable possibility” is not the same as “more than remote”.</p> <p>ED 315 Task Force are proposing to change the relevant assertion to:</p> <p>“an assertion about a Class of Transactions, Account Balances and Disclosures and Relevant Assertions (COTABD) is relevant when it has an identified risk of material misstatement. The determination is made before consideration of controls”.</p> <p>The Task Force are examining options on how to clarify and explain how the “reasonable possibility” threshold is used to identify ROMM. Should this be in ISA 200 or 315? The IAASB have been asked to consider 3 options:</p> <ol style="list-style-type: none"> 1. amend definitions of ROMM and detection risk in ISA 200 to include “reasonable possibility” 2. Add application material to ISA 200 to explain; or 3. make no changes to ISA 200 but clarify in the application material of ED 315 <p>Definition of Significant COTABD to remain as per the ED:</p> <p>“Significant COTABD for which there is one or more relevant assertions”</p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>Question for the AUASB:</p> <p>Do you have a preference (1 – 3 above) for how concept of reasonable possibility is incorporated into how to identify ROMM?</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>Yet to be addressed. At this stage IRFs are still in the definition of significant risk.</p>

Matters raised in the ED 315 submission by the AUASB	How the ISA 315 Task Force has (or has not) address the AUASB's feedback
<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>Consistent with other feedback. The ED 315 Task Force recommendation is:</p> <ul style="list-style-type: none"> • Keep the concept of spectrum of inherent risk and include guidance on how to assess where on the spectrum a risk would reside with illustrations. • Change 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 trade receivables unlikely to be a SR but the valuation could be). <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> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>Question for the AUASB:</p> <p>Do you agree with the ED 315 Task Force proposals?</p> </div>
<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>Not yet addressed</p>

Matters raised in the ED 315 submission by the AUASB	How the ISA 315 Task Force has (or has not) address the AUASB's feedback
<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>Not yet addressed</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>A main focus of the Task Force. Still being determined how to address. Terminology has been changed but also considering using “Scalability paragraphs”</p>

Matters raised in the ED 315 submission by the AUASB	How the ISA 315 Task Force has (or has not) address the AUASB's feedback
<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>Yet to be addressed</p>

Matters raised in the ED 315 submission by the AUASB	How the ISA 315 Task Force has (or has not) address the AUASB's feedback
<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>Yet to be addressed.</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>Consistent with feedback from other respondents. Overarching comments that needed to be reconsidered as confusing. And is the auditor always required to identify “controls relevant to the audit” if doing a fully substantive audit? Also significant confusion about the difference between the Information System and Communication component and the Control activities.</p> <p>As a result the ED 315 Task Force have re-drafted requirements in the Understanding the entity’s system of Internal Control section and is being presented to the IAASB at this meeting. Application material is yet to be presented.</p> <p>The ED 315 Task Force have focused on the following in the proposed redrafted requirements:</p> <p>Include more on why this understanding is required e.g. Paragraph 25.</p> <p>Clarifies the auditor evaluates whether the Information System and Communication component appropriately supports the preparation of the entity’s financial statements how SCOTABD flow through the system.</p> <p>Clarity over the description of control activities component and that they may reside in all the components of the system of internal controls.</p> <p>Reducing complexity in the requirements to perform D & I.</p> <p>The terminology “controls relevant to the audit” has been changed to “identify controls” that meet certain criteria (ie. then do D & I). The criteria for the controls to identify are still the same as ED 315 except Paragraph 39 (e) has been removed. Also clarified that these controls may reside in the other components.</p> <p>D & I over controls for journals is still required.</p> <p>In summary AUASB’s concerns have been considered.</p>

Matters raised in the ED 315 submission by the AUASB	How the ISA 315 Task Force has (or has not) address the AUASB's feedback
<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>Not yet addressed</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>All points were raised by other stakeholders and the ED 315 Task Force are proposing:</p> <ul style="list-style-type: none"> • separate assessments of inherent and control risk assessments will remain • Assessing control risk at maximum if not testing controls was supported and will be retained. • Whilst many respondents agreed with our third point and suggested changing the initial identification of “risks of material misstatement” to identify “inherent risks” the ED 315 Task Force is concerned this may result in the identification of risk of material misstatements being performed without understanding the system of internal control. <p>The ED 315 Task Force are proposing to change paragraph 45 to identify the ROMM at the assertion level..... based on inherent risk (was previously “taking into account the inherent risk factors”).</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>Not addressed at this stage</p>

Matters raised in the ED 315 submission by the AUASB	How the ISA 315 Task Force has (or has not) address the AUASB's feedback
<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>Mixed views from respondents. On balance the ED 315 Task Force has proposed that "stand back" provisions will be in both ED 315 and ISA 330 and changes proposed:</p> <p>The references to qualitative and quantitative in the context of materiality will be removed in both ED 315 and ISA 330.</p> <p>ED 315 Paragraph 52 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:</p> <p>Evaluate whether the auditor's conclusion that there are not related risks of material misstatement remains appropriate.</p> <p>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.</p> <p>Do the AUASB have any concerns with this proposal?</p>

17. 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

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

Material Presented

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| Agenda Item 7.1.0 | ED 315 AUASB Board Meeting Summary Paper |
| Agenda Item 7.1.1 | IAASB ED 315 Agenda Paper 4A – Table of Drafting |