



Australian Government
Auditing and Assurance Standards Board

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Mr Dan Montgomery
Technical Director
International Auditing and Assurance Standards Board
International Federation of Accountants
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New York, New York 10017 USA

Dear Dan,

**AUASB Submission on the IAASB's Proposed International Standard on Auditing ISA 315
(Revised) *Identifying and Assessing the Risks of Material Misstatement***

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to comment on the IAASB's Proposed International Standard on Auditing ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement* (ED 315), and conforming amendments to other ISAs.

In formulating its response, the AUASB has sought input from its stakeholders in three principal ways. The first was from hosting a series of roundtable meetings with stakeholders in six of the large Australian cities - stakeholders representing a broad range of backgrounds including assurance providers from small, medium and large audit firms, professional accounting bodies, directors and preparers of financial statements. The second was through an open invitation to provide comments on the AUASB issued equivalent exposure drafts; and the third was by way of formal discussions by the AUASB members at recent AUASB meetings.

Overall the AUASB is supportive of the IAASB's proposed revisions to ISA 315. The AUASB considers these revisions will achieve the objective of establishing more robust requirements and appropriately detailed guidance to drive auditors to perform consistent and effective risk assessment. However the AUASB raises the following key point for the IAASB's consideration.

Whilst we support the IAASB's intention to ensure ED 315 can be applied to the audits of small, non-complex entities to large, complex, multinational entities, its complexity and length makes scalability challenging. The AUASB considers that the definitions of relevant assertions and significant risks further impact the scalability of ED 315. The AUASB recommends that the IAASB further enhance ED 315 to improve scalability and that non-authorative guidance in the form of frequent asked questions and examples are developed to assist with implementation. Please refer to question 2 of our submission for further our suggestions on how to achieve this.

Please refer to our detailed comments in Appendix 1.

Should you have any queries regarding this submission, please do not hesitate to contact me or Matthew Zappulla at mzappulla@auasb.gov.au.

Yours sincerely,

Professor Roger Simnett AO
Chair

Draft

1. Has ED 315 been appropriately restructured, clarified and modernised in order to promote a more consistent and robust process for the identification and assessment of the risks of material misstatement? In particular:

(a) Do the proposed changes help with the understandability of the risk identification and assessment process?

Yes. The AUASB considers that ED 315 has provided significant clarification about the risk identification and assessment process and has been appropriately restructured, clarified and modernised. We support the principles-based approach in ED 315 whilst providing a more granular and robust process which we believe promotes understandability and aids in identifying and assessing the risks of misstatement.

Whilst we understand that risk identification and assessment is a complex and iterative process with many steps occurring concurrently, ED 315 is complex and its length may be a barrier to its understandability, and scalability. The IAASB should also consider the following to assist with the overall understandability of ED 315:

- Whether some content in the application material may be included in other non-authoritative guidance. Refer to question 2 for further comments.
- Clearer linkage between the “understanding” obtained regarding each of the components of the entity’s system of internal control and how this is applied to identify and assess the risks of material misstatement. Refer to question 5 for further comments.
- Further clarification on how inherent risk and control risk interact and combine when assessing the risks of material misstatement. Refer question 6a for further comments.

(a) (continued) Are the flowcharts, prepared by the IAASB, helpful in understanding the flow of the standard (i.e., how the requirements interact and how they are iterative in nature)? If yes, should they be included in the final Standard?

The flowcharts are helpful in understanding ED 315. The AUASB supports the flowcharts being included as appendices to the final standard. In the AUASB’s view the flowcharts could be further enhanced to clearly present and emphasise what is inherently an iterative process in a more straight forward manner.

(b) Will the revisions promote a more robust process for the identification and assessment of the risks of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6–28 of the IAASB’s Explanatory Memorandum.

The AUASB agrees that ED 315 provides a more granular and robust process for the identification and assessment of the risks of material misstatement. We believe this more granular and robust processes will assist with consistency of the risk identification and assessment process. We also agree that any public interest issues are well addressed.

(c) Are the new introductory paragraphs helpful?

The AUASB considers the introductory paragraphs greatly assist with the understandability of the risk identification and assessment process and explain important concepts, however the AUASB believe that to avoid confusion it would be useful to describe the status of these paragraphs (ie. are they authoritative?) We also consider that the introductory paragraphs should be enhanced as follows:

- Paragraph 4 should state more clearly that the initial identification of risk of material misstatement is based on the inherent risk assessment only.
- Describe the “spectrum of inherent risk” in more detail or refer to the application material.
- Provide an overview of the identification and assessment of the risk of material misstatement at the financial statement level.

2. Are the requirements and application material of ED 315 sufficiently scalable, including the ability to apply ED 01/18 to the audits of entities with a wide range of sizes, complexities and circumstances?

We support the IAASB's intention to ensure ED 315 can be applied to the audits of small, non-complex entities to large, complex, multinational entities. The AUASB considers that scalability could be enhanced by the following:

- The length of ED 315 is a barrier to understanding the standard, and in particular for audits of smaller and less complex entities. We recommend that the IAASB consider how the application material in ED 315 can be reduced. Refer to question 1a for further comments.
- ED 315 uses the term smaller and less complex entities. However complexity is the key driver in scalability when performing risk assessment. Smaller entities may be complex, and conversely larger entities may be less complex. We recommend the terminology used in ED 315 should refer to "less complex entities" which will allow this guidance to be used in audits regardless of size. We note that "less complex entities" is the terminology used in the IAASB's future discussion paper on this topic.
- The use of the term "more than remote" in the definition of Relevant Assertion will increase the audit work effort over low risk balances as most assertions will meet this test, and therefore will result in more significant classes of transactions, account balances, or disclosures. Refer to question 6d for further comments.
- Provide more guidance and examples on how to effectively scale the work effort to less complex entities such as:
 - An example of how to perform risk identification and assessment for a less complex entity where a mainly substantive audit approach will be adopted to be included in the application material.
 - Examples of how the system of internal control may be less detailed and formalised.
 - How to gather the understanding of the IT environment / identification of risks arising from IT and identification and evaluation of GITCs.

3. Do stakeholders agree with the approach taken to enhancing ED 01/18 in relation to automated tools and techniques, including data analytics, through the use of examples to illustrate how these are used in an audit (see Appendix 1 of the IAASB's Explanatory Memorandum for references to the relevant paragraphs in ED 01/18)? Are there other areas within ED 315 where further guidance is needed in relation to automated tools and techniques, and what is the nature of the necessary guidance?

Yes, the AUASB agrees with the approach taken of using examples to illustrate how automated tools and techniques may be used in risk assessment. Our stakeholders support the explicit reference to and including of examples of automated tools and techniques in ED 315. We are also supportive of avoiding terminology that may become outdated quickly.

We consider that ED 315 should also address:

- 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 of the standard.
- 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 is 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.

In addition paragraph 54 and A15, A18 and A32 – 33 could be enhanced by:

- Risk considerations or documentation requirements specific to the use of predictive analytics or analytic tools that incorporate machine learning or artificial intelligence (AI) by both entities and auditors, particularly the nature of what is considered “Audit Evidence”.
- Documentation requirements for analytic procedures to allow for re-performance where machine learning is used by an entity and/or the auditor.
- Consideration of the requirements in relation to General Information Technology Controls testing and database control assurance required when using automated tools as part of risk assessment.
- Documentation requirements on the appropriateness and reliability of external data sets (being data sets external to the entity’s sphere of control).
- Guidance on how audit analytics and automated tools can be used to assess qualitative inherent risks factors described in section A5.

4. Do the proposals sufficiently support the appropriate exercise of professional scepticism throughout the risk identification and assessment process? Do you support the proposed change for the auditor to obtain ‘sufficient appropriate audit evidence’¹ through the performance of risk assessment procedures to provide the basis for the identification and assessment of the risks of material misstatement, and do you believe this clarification will further encourage professional scepticism?

The AUASB agrees that the application of professional scepticism is reinforced throughout the risk identification and assessment process in ED 315. Specifically we agree with the principles-based approach and reference to the concept of professional scepticism in the introductory paragraphs, rather than prescriptive requirements.

Based on academic research we recommend the following enhancements to ED 315 to encourage higher levels of professional scepticism:

- Paragraph 22 - the engagement partner is to use professional judgment to decide the format of instructions provided, and who will participate, when conducting the discussion.
- Paragraph A45 - be expanded to note that the engagement partner should be cognisant, when communicating with those not included in the discussion, that what they communicate, and how they communicate, might lead to auditor bias which can, depending on the circumstances, both positively and negatively impact the level of professional scepticism being exercised.
- Paragraph A19 include reference to broad sources of information (that may include but not limited to the points noted) so as to avoid consciously and/or subconsciously narrowing the breadth of information search.
- Paragraph A42 include the other benefits of the engagement team discussion including helping auditors to be open to new information, and different interpretations of the information, and to limit the possibility of prematurely forming a belief.

The AUASB is supportive of the principle of obtaining an appropriate base of evidence for risk assessment. However some stakeholders have raised concerns about using the term “sufficient appropriate audit evidence” in paragraph 17, as this term is associated with drawing conclusions on the evidence collected on the financial statements as a whole and not during the risk identification and assessment phase. We have also noted that using this term in ED 315 is inconsistent with the definition of audit evidence in ISA 200. We believe the IAASB need to consider if paragraph 17 is appropriate, and the impact this has on ISA 200. We also recommend that further guidance is required to explain how this is to be interpreted.

5. Do the proposals made relating to the auditor’s understanding of the entity’s system of internal control assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks or material misstatement? Specifically:

¹ See paragraph 27 of the IAASB’s Explanatory Memorandum and paragraph 17 of ED 01/18

- (a) **Have the requirements related to the auditor’s understanding of each component of the entity’s system of internal control been appropriately enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?**

The AUASB considers that ED 315 provides greater clarity in relation to what is required when obtaining an understanding of each component of the entity’s system of internal control and how this informs the risk identification and assessment process. Additionally the flowcharts and the updated definitions provide greater clarity. However in the AUASB’s view the following changes are required to enhance clarity and flexibility:

paragraph 35 (a) (ii) “Information about significant events and conditions...”

paragraph 39 (a) “... procedures alone ~~do~~ may not provide sufficient...”

paragraph 40 (d) “... substantive procedures alone ~~do~~ may not provide sufficient ...”

- (b) **Have the requirements related to the auditor’s identification of controls relevant to the audit been appropriately enhanced and clarified? Is it clear how controls relevant to the audit are identified, particularly for audits of smaller and less complex entities?**

The AUASB considers that ED 315 paragraph 39 (and A166 and A167) provides clarity on the identification of controls relevant to the audit, including clarifying that most controls that are relevant to the audit will be direct controls in the Information System and Communication and Control Activities components. We recommend that the IAASB clarify the intention of 39(e), or consider removing this, as the controls relevant to the audit are captured appropriately in the preceding elements of this paragraph.

Para A166 and A167 provide appropriate clarity that based on their judgement of the complexity and size of an entity conclude that the only relevant controls are those over journal entries if they do not plan to rely on any of the other controls.

- (c) **Do you support the introduction of the new IT-related concepts and definitions? Are the enhanced requirements and application material related to the auditor’s understanding of the IT environment, the identification of the risks arising from IT and the identification of general IT controls sufficient to support the auditor’s consideration of the effects of the entity’s use of IT on the identification and assessment of the risks of material misstatement?**

The AUASB supports the introduction of the new IT-related concepts and definitions. We agree that the enhancements contained in ED 315 assist greatly in understanding the impact of the IT environment and how to identify IT controls including general IT controls which are relevant to the audit.

We consider that ED 315 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.

6. **Will the proposed enhanced framework for the identification and assessment of the risks of material misstatement result in a more robust risk assessment? Specifically:**

- (a) **Do you support separate assessments of inherent and control risk at the assertion level, and are the revised requirements and guidance appropriate to support the separate assessments’?**

The AUASB supports the separate assessments of inherent and control risk at the assertion level and consider that the related requirements and guidance are appropriate. We are also

² See ED 01/18, paragraphs 39-40 and paragraphs 37-40 of the IAASB’s Explanatory Memorandum

supportive of the explicit requirement to assess control risk at maximum if the operating effectiveness of controls are not being tested.

We recommend that the IAASB provide clarity on how this separate assessment is done through the following changes:

- Paragraph 45 should reflect that it applies to the Inherent Risk component of risk of material misstatement not the combined risk of material misstatement (after combination of control risk).
- Describe how these assessments are combined to determine the risk of material misstatement.
- Providing detail on how to assess control risk. ED 315 only refers to the concepts of maximum, or less than maximum.

(b) Do you support the introduction of the concepts and definitions of ‘inherent risk factors’ to help identify risks of material misstatement and assess inherent risk? Is there sufficient guidance to explain how these risk factors are used in the auditor’s risk assessment process?

The AUASB supports the concepts and definitions of inherent risk factors and how they are used to identify risks of material misstatement and assess inherent risk. We consider this will result in more robust risk identification and assessment as will help auditors focus on the characteristics that affect susceptibility to misstatement.

However as “Inherent Risk Factors” (16(f) and A6) include the quantitative significance of a class of transactions, account balance or disclosure in relation to performance materiality, it would appear that all material items would have a risk of material misstatement and be identified as significant. We question if this is the intended consequence and do not agree that all classes of transactions, account balances or disclosures should be considered “significant” based on quantitative factors along which is how 16(f) and A6 may be interpreted. This will also impact whether a stand back requirement is required in both ED 315 and ISA 330 (refer question 8 for further comments).

(c) In your view, will the introduction of the ‘spectrum of inherent risk’ (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks?

The AUASB is supportive of the introduction of the “spectrum of inherent risk” and auditors considering how inherent risk factors individually or in combination increase inherent risk to varying degrees. The consideration of inherent risk factors and the concept of the spectrum of inherent risk help auditors consider the susceptibility to misstatement and the risks, when assessing inherent risk.

However we believe more guidance is required to assist auditors to determine at which point on the spectrum a risk resides, and where on the scale of likelihood and magnitude would result in a significant risk i.e. would a low likelihood and high magnitude result in a significant risk. Refer 6(e) for further comments on the definition of significant risk.

(d) Do you support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and their relevant assertions? Is there sufficient guidance to explain how they are determined (i.e., an assertion is relevant when there is a reasonable possibility of occurrence of a

misstatement that is material with respect to that assertion),³ and how they assist the auditor in identifying where risks of material misstatement exist?

We are supportive of the proposed definitions of significant classes of transactions, account balances and disclosures. However we are not supportive of the proposed definition of relevant assertions. A relevant assertion is an assertion where there is a “reasonable possibility” of occurrence of a misstatement, which is defined as when the likelihood of a material misstatement is “more than remote”. No guidance is provided on how to assess this. Our stakeholders strongly consider that “more than remote” is different to “reasonable possibility”, and are concerned that this will create issues for scalability, as many assertions may meet this test, and therefore result in more significant significant classes of transactions, account balances, or disclosures being identified. We do not agree this is the desired outcome. More guidance is required.

The AUASB is aware of research that supports that these terms are interpreted differently by auditors. The AUASB can share this research with the IAASB if requested.

(e) Do you support the revised definition,⁴ and related material, on the determination of ‘significant risks’? What are your views on the matters presented in paragraph 57 of the IAASB’s Explanatory Memorandum relating to how significant risks are determined on the spectrum of inherent risk?

We support the definition of significant risk being aligned to the nature of the risk and the suspectability to fraud or error, and not the auditor’s response to a risk as it is in extant ISA 315. To provide further clarity on this definition, the AUASB recommends:

- The definition of significant risk 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”.
- Additionally as stated above in question 6(c) additional guidance is required in how to assess where on the spectrum a risk resides, and where a significant risk resides on the scale of likelihood and magnitude.
- Paragraph A10 be enhanced to explain how the “spectrum of inherent risk” works in identifying significant risks. A10 focuses more on the implications for the audit, and not on the identification of inherent risk.

In relation to the definition of significant risk and the matters presented in paragraph 57 of the IAASB’s Explanatory Memorandum, stakeholders had differing views as to whether the term high likelihood of occurrence OR the magnitude of potential misstatement, or high likelihood of occurrence AND the magnitude of the potential misstatement, is the most appropriate. The IAASB’s Explanatory Memorandum details that the IAASB’s view is that for risks low in likelihood, but for which the magnitude could be very high if it occurred, it wasn’t appropriate to explicitly exclude these from the auditor’s determination of significant risks. The AUASB considers, risks with a very low likelihood, but high magnitude should not be automatically significant risks, and therefore the definition should be changed so auditors consider likelihood and magnitude in combination when determining significant risk.

7. Do you support the additional guidance in relation to the auditor’s assessment of risks of material misstatement at the financial statement level,⁵ including the determination about how, and the degree to which, such risks may affect the assessment of risks at the assertion level?

Yes the AUASB agrees that the additional guidance in relation to financial statement level risks explains how these are assessed at the assertion level. However we consider that auditors find this difficult in practice and more guidance or examples could be provided. We note that Appendix 2

³ See footnote 26 of the IAASB’s Explanatory Memorandum.

⁴ Paragraphs 16(k) and A10, and A229-A231 of ED 01/18.

⁵ Paragraphs 47 and A215–A220 of ED 01/18.

only includes examples of risks of material misstatement at the assertion level and should also include at least one example of risk of material misstatement at the financial statement level, and how this may affect the assessment of risks at the assertion level.

- 8. What are your views about the proposed stand-back requirement in paragraph 52 of ED 01/18 and the proposed revisions made to paragraph 18 of ISA 330 and its supporting application material? Should either or both requirements be retained? Why or why not?**

The AUASB supports the concept of a stand back requirement in ED 315. Our stakeholders had mixed views as to whether the stand back requirement is better placed in ED 315 or ISA 330, however there was consensus that it is not required in both. On balance the majority of our stakeholders prefer a stand back requirement in ED 315 as this will result in a more robust risk assessment process, which is important in improving overall audit quality. Therefore if a class of transactions, account balances or disclosures has not been assessed as significant as there is no risk of material misstatement then ISA 330 paragraph (18) should not be required.

However as “Inherent Risk Factors” (16(f) and A6) include the quantitative significance of a class of transaction, account balance or disclosure in relation to performance materiality, it would appear that all material items would be considered significant. We question if this is the intended consequence and do not agree that all classes of transactions, account balances or disclosures should be considered significant based on quantitative factors along which is how 16(f) and A6 may be interpreted. Refer to question 6(b).

Conforming and consequential amendments

- 9. With respect to the proposed conforming and consequential amendments to:**

- (a) ISA 200 (including Appendix 2), ISA 240 and ED 03/18, are these appropriate to reflect the corresponding changes made in proposed ISA 315?**

Refer to question 4. Using the term “sufficient appropriate audit evidence” in paragraph 17 is inconsistent with the definition of audit evidence in ISA 200. We believe the IAASB need to consider if paragraph 17 is appropriate, and the impact this has on ISA 200.

- (b) ISA 330, are the changes appropriate in light of the enhancements that have been made in proposed ISA 315, in particular as a consequence of the introduction of the concept of general IT controls relevant to the audit?**

No matters noted.

- (c) The other ISAs as presented in Appendix 1, are these appropriate and complete?**

A stakeholder requested that the IAASB also consider reviewing whether confirming amendments are necessary for ISA 402 and ISA 600.

- 10. Do you support the proposed revisions to paragraph 18 of ISA 330 to apply to classes of transactions, account balances or disclosures that are ‘quantitatively or qualitatively material’ to align with the scope of the proposed stand-back in proposed ISA 315?**

The AUASB supports the removal of ISA 300 paragraph 18. Refer to question 8.

- 11. Effective date: the IAASB have proposed that the standard will be effective for financial reporting periods commencing no or after 15 December 2020, which is anticipated to be approximately 18 months after approval of the final ISA. Do you think this is a sufficient period to support effective implementation of the new standard?**

Effective date is appropriate.

Other matters raised by stakeholders

We also highlight the following for the IAASB's consideration:

Documentation:

Stakeholders raised overall concerns about the level of documentation that may be required to evidence compliance with ED 315. To assist auditors the AUASB recommend that the IAASB issue non-authoritative guidance outlining the documentation requirements specific for a less complex entity.

Public sector considerations

We received feedback from public sector auditor representatives that the considerations specific to the public sector do not articulate their requirements to consider the risks of probity and propriety and the need to comply with legislated financial accountability frameworks (ED 315 - A36).

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