



AUASB Board Meeting Summary Paper

AGENDA ITEM NO. **4.1.1**

Meeting Date: 12 September 2018

Subject: ED 01/18 *Proposed Auditing Standard ASA 315 Identifying and Assessing the Risks of Material Misstatement*

Date Prepared: 28 August 2018

Action Required

For Information Purposes Only

Agenda Item Objectives

1. To obtain the AUASB's feedback and views on ED 01/18 *Proposed Auditing Standard ASA 315 Identifying and Assessing the Risks of Material Misstatement* (ED 315) in order to identify matters:
 - a) to be included in the AUASB's submission to the IAASB;
 - b) to discuss with our stakeholders at the upcoming roundtables; and
 - c) which may be considered as compelling reasons for Australian specific content.

Background

2. The IAASB's objective in re-issuing ISA 315 is to establish a more appropriate and robust risk assessment process, as well as:
 - a) focus on scalability;
 - b) deal with changing technology and its impact on business risks and the audit process;
 - c) enhance application of professional scepticism;
 - d) to clarify the nature and extent of the procedures to be conducted over internal controls; and
 - e) develop further guidance and tools to support implementation.
3. In July 2018, the IAASB released for comment ED ISA 315 with submissions due by 2 November 2018.
4. The AUASB is seeking feedback on ED 315 via:

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.

- a) ED 315 and ED 02/18 *Proposed Auditing Standard ASA 2018-1 Amendments to Australian Auditing Standards* (Conforming and consequential amendments arising from the proposed revisions to ASA 315) which were released on 7 August in Australia for public comment, with responses due 15 October 2018.
 - b) Roundtables in the following locations:
 - Perth - 20 September 2018
 - Hobart - 25 September 2018
 - Adelaide - 2 October 2018
 - Canberra - 3 October 2018
 - Brisbane - 10 October 2018
 - Sydney - 11 October 2018
 - Melbourne - 12 October 2018
 - c) The AUASB-NZAuASB webinar recorded by the IAASB ISA 315 Task Force leader Fiona Campbell has been communicated to our stakeholders via our newsletter and is available via our website, and includes an invitation to provide comments to the AUASB.
5. The IAASB has requested feedback on very detailed questions, which are included in Appendix 1. The matters included in section 2 and the questions for the AUASB in section 3 of this paper, cover the questions from the IAASB. In addition the roundtable discussions based on these questions, as well as stakeholder written submissions, will further inform the AUASB when responding to the IAASB.

Structure of this paper

6. This paper is set out as follows:
- Section 1 – Overview of ASA 315 and key changes from extant ASA 315
 - Section 2 – Matters identified to date for discussion
 - Section 3 – Actions and questions for the AUASB
 - Section 4 – Conforming amendments
 - Section 5 – Timetable
 - Section 6 – Other matters

Section 1 – Overview of ED 315 and key changes from extant ASA 315

7. In summary the main changes are:
- a) New introductory paragraphs which provide a summary of the standard and key concepts.

- b) There are a number of new and revised definitions, notably significant risk and relevant assertions. Refer to section 2 for analysis of the new definitions for significant risks and relevant assertion. No other issues were noted.
- c) Inherent risk factors and a new concept of spectrum of inherent risk is used when determining significant risks. Refer section 2 below.
- d) Whilst the overall number of requirements has increased, many are an expansion of the existing requirements in practice, providing more detail on how to perform risk assessment and identify controls relevant to the audit, including information technology (IT) and general IT controls. The following are new:
 - ◆ Requirement to separately identify inherent and control risk at the assertion level.
 - ◆ Explicitly requires the auditor to assess controls risk as maximum if not testing operating controls.
 - ◆ Enhanced and more detailed requirements in relation to how to identify and when to test design and implementation of controls relevant to the audit including IT, and general IT controls. Refer section 2 below for further discussion.
 - ◆ Identify significant risks based on the assessment of inherent risk ie. new definition of significant risk.
 - ◆ New standback provision. Refer section 2 below for further discussion.
- e) The standard is now much longer mainly due to more explanatory materials and appendices.

Section 2 – Matters identified to date for discussion

8. The following includes the matters previously raised by the AUSAB on previous drafts of ED 315, as well as additional items noted by the ATG on review of the final ED 315.

Matter	ATG view
<ul style="list-style-type: none"> • Concern that the standard was overly complex and the order was not correct ie. identifying ROMM before assessing IR and CR 	<ul style="list-style-type: none"> • The introductory paragraphs have been updated and explain the key concepts and flow of the standard well. The introductory paragraphs explain that risk assessment is “iterative and dynamic” and the auditor develops initial potential ROMMs based on the understanding of the entity and its environment and the applicable financial reporting framework. They continue to assess the ROMMs through the risk assessment process. • The IAASB have prepared three flowcharts to assist with understanding of ED 315. • The comparison of ED 315 to extant ASA 315 demonstrates that there are more requirements in ED 315, however many are expanding on existing requirements. Refer to SEP18_4.1.2_Comparisontoextant315 for this analysis. • The requirements have been expanded to improve the robustness of the risk assessment

	<p>process. In particular identification of controls including IT.</p> <ul style="list-style-type: none"> • Feedback will be sought at the roundtables as to the overall flow and understandability of the standard, including whether the flowcharts are helpful. • Overall the ATG is comfortable with the order of the standard, and that the enhanced requirements improve the robustness of the risk assessment process. • To be discussed further with the AUASB.
<ul style="list-style-type: none"> • The definition of significant risk has changed and includes the concept of spectrum of inherent risk. This is explained in the introductory paragraphs. The term spectrum of inherent risk isn't the requirements. Is it clear how this concept works with the inherent risks and identification of significant risks? 	<ul style="list-style-type: none"> • This point is still valid. • The requirement to identify significant risks is based on the assessment of inherent risk which considers the inherent risk factors. The spectrum of inherent risk is not in the wording of the requirement but is in the definition of significant risk. • There is explanatory material to assist A221 – A230. • Is the definition of significant risk appropriate? • To be discussed further with the AUASB.
<ul style="list-style-type: none"> • Inherent risk factors (IRF) (which are used when assessing inherent risk) incorporates qualitative and quantitative factors. <p>Concern that this may result in a low risk, large sized items being identified as a significant account.</p>	<ul style="list-style-type: none"> • Still included in IRF. • Explanatory material A5 to A6 explains the IRF and includes quantitative as an other IRF. Refer also A222. • The ATG are of the view that it is appropriate to include quantitative factors in the IRF. IRFs are used to assess inherent risk which paragraph 48 of ED 315 requires the auditor to assess inherent risk by assessing the likelihood and magnitude of material misstatement. • It is appropriate to consider the size when considering ROMM. • To be discussed further with the AUASB.
<ul style="list-style-type: none"> • Definition of relevant assertions is when there is a reasonable possibility of a material misstatement. Reasonable possibility is defined as where the likelihood of a material misstatement is more than <u>remote</u>. <p>Concern that reasonable possibility and more than remote are different, and increased work effort where not considered necessary. ie. will result in more significant accounts.</p>	<ul style="list-style-type: none"> • Concern still exists and noted for feedback to the IAASB. • Will be discussed at the roundtables to gather stakeholder's views. • To be discussed further with the AUASB.
<ul style="list-style-type: none"> • Consider whether definitions of class of transaction and account balances is required as there is a risk auditors may disaggregate items. 	<ul style="list-style-type: none"> • Will be discussed at the roundtables to gather stakeholder's views. • To be discussed further with the AUASB.

<ul style="list-style-type: none"> ED 315 Paragraph 27 Control Environment – includes items which are difficult to gather evidence on. 	<ul style="list-style-type: none"> Paragraph 27 has not changed from the previous draft ISA 315, however there is new explanatory material (A105 and following) which assists including how to gather this evidence. To be discussed further with the AUASB.
<ul style="list-style-type: none"> ED 315 paragraph 31 (b) – should there be a significance test? 	<ul style="list-style-type: none"> This has not changed. However note that wording is “determine whether” which allows the auditor to use professional judgement. To be discussed further with the AUASB.
<ul style="list-style-type: none"> ED 315 paragraph 34 and explanatory material A 131 – A135, refers to consideration of the work performed by internal audit. ASA 610 includes an Australian compelling reason difference to the ISA in relation to prohibition of using the work of internal audit for direct assistance. 	<ul style="list-style-type: none"> This raises the potential for an Aus paragraph in the explanatory material re-stating that using the work of internal audit for direct assistance is prohibited. To be discussed further with the AUASB.
<ul style="list-style-type: none"> ED paragraph 35(a) (ii) “information about events and conditions” - is too broad. 	<ul style="list-style-type: none"> This has not changed. To be discussed further with the AUASB.
<ul style="list-style-type: none"> ED 315 paragraphs 36, 39 – 41 includes more explicit / enhanced requirements in relation to how to identify and when to test design and implementation of controls relevant to the audit, including IT and general IT controls. 	<ul style="list-style-type: none"> The requirements and explanatory material has been significantly enhanced from extant 315. In many instances the requirements are clarifying what should have been done and make sense. Now explicitly requires design and implementation testing for GITCs relevant to the audit. To be discussed further with the AUASB.
<ul style="list-style-type: none"> ED 315 paragraph 52 is a new requirement and is a stand back provision requiring the auditor to reassess classes of transactions, account balances and disclosures which have not been assessed as significant. 	<ul style="list-style-type: none"> This is a double check that the risk assessment has been performed properly. Intended to drive an evaluation of the completeness of the identification of significant classes of transactions, account balances and disclosures. Required for Material classes of transactions, account balances and disclosures, which have not been deemed significant. Note that ISA 330 has a similar purpose but is different as results in substantive procedures being performed on any material class of transaction, account balance, or disclosures which haven’t been identified as significant. To be discussed further with the AUASB.
<ul style="list-style-type: none"> The explanatory material includes more extensive guidance throughout on scalability for “smaller and less complex entities” which is changed from the term “smaller entities” in the extant ISA 315. Note that the Task Force considered “smaller or less complex” however 	<ul style="list-style-type: none"> Paragraph 13 of ED 315 explains scalability and the concept of smaller and less complex entities. It also says that some of the considerations may be useful in audits of larger and less complex entities. To be discussed further with the AUASB.

determined “and” to be appropriate, as complexity is the major factor in relation to scalability.	
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Section 3 – Action and questions for the AUASB

9. Read ED 315 in order to provide feedback and discuss:

- a) The issues noted above in section 2.
- b) Are there other matters identified by the AUASB which should be discussed with stakeholders at the roundtable for consideration to be included in the submission to the IAASB?
- c) Has ED 315 been appropriately restructured, clarified and modernised in order to promote a more consistent and robust risk assessment process?
 - (a) Are the flowcharts helpful and should they be included in the final Standard?
 - (b) Are the introductory paragraphs helpful?
- d) Are the requirements and application material sufficiently scalable?
- e) Does the AUASB agree with the approach to automated tools and techniques? ie. inclusion of examples to illustrate how these may be used in an audit. Any other areas where they should be included?
- f) Will the enhancements support appropriate exercise of professional scepticism?
- g) Are there any potential compelling reasons identified?

10. The following is also available to assist the AUASB in its review of ED 315:

- a) SEP18_4.1.2_Comparisontoextant315 for a comparison and analysis of the requirements of ED 315 compared to extant ASA 315.
- b) The IAASB’s explanatory memorandum explains in detail the background on all significant changes - [Exposure Draft, ISA 315 \(Revised\), Identifying and Assessing the Risks of Material Misstatement | IFAC](#)
- c) The IAAAB’s ED 315 Flowcharts:
 - (a) SEP18_4.1.5_ISA315riskassessmentflowchart
 - (b) SEP18_4.1.6_ISA315internalcontrolflowchart
 - (c) SEP18_4.1.7_ISA315ITenvironflowchart

Section 4 – Conforming amendments

11. Proposed conforming amendments are included in SEP18_4.1.4_ED 0218 Proposed Auditing Standard ASA 2018-1 Amendments to Australian Auditing Standards (Conforming and consequential amendments arising from the proposed revisions to ASA 315). Refer SEP18_4.1.4_ED0218Conformingamendments.
12. The conforming amendments in ASA 540 *Auditing Accounting Estimates and Related Disclosures* are not included in ED 03/18 *Proposed Auditing Standard ASA 540 Auditing Accounting Estimates and*

Related Disclosures, as ISA 540 was approved by the IAASB before the conforming amendments as a result of ED 315 were finalised. These conforming amendments are included in ED 02/18.

13. Most conforming amendments are due to changes in terminology and won't have a significant impact. No issues have been identified by the ATG in these amendments, and this will be considered further once feedback is received from stakeholders to ED 02/18.

Section 5 – Timetable

As agreed at the AUASB meeting on 31 July 2018:

20 September – 12 October 2018	Roundtables in Perth, Hobart, Adelaide, Canberra, Brisbane, Sydney, Melbourne (in conjunction with ASA 540)
15 October 2018	Comment period closes
24 October 2018	Draft ED IAASB submission sent to AUASB
29 October 2018	AUASB meeting to approve submission to IAASB
2 November 2018	Send final submission to IAASB

Section 6 - Other Matters to Consider

NZAuASB

14. NZAuASB have issued ED 315 in New Zealand and are holding roundtables in August and September 2018. The AUASB will continue to liaise with NZAuASB about ED 315 and its response to the IAASB.

Compelling Reasons Assessment

15. The AUASB will also be informed about potential compelling reasons based on feedback from stakeholders.
16. Refer to section 2 above for a potential compelling reason in relation to internal audit. The AUASB will consider this further including any other matters based on feedback from stakeholders. No other compelling reasons have been identified to date.

Material Presented

- Agenda Item 4.1.1 SEP18_4.1.1_ED0101ASA315BMSP
- SEP18_4.1.2_Comparisontoextant315
- SEP18_4.1.3_ED315
- SEP18_4.1.4_ED0218Conformingamendments
- SEP18_4.1.5_ISA315riskassessflowchart
- SEP18_4.1.6_ISA315internalcontrolflowchart
- SEP18_4.1.7_ISA315ITcontrolsflowchart

Action Required

No.	Action Item	Deliverable	Responsibility	Due Date	Status
1.	Refer section 3		AUASB	12 September 2018	

Exposure Draft Questions

Stakeholders are asked to respond to the AUASB on the following questions in order to inform us when responding to the IAASB:

ED 01/18

1. Has ED 01/18 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?
 - (b) 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?
 - (c) 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.
 - (d) Are the new introductory paragraphs helpful?
2. Are the requirements and application material of ED 01/18 sufficiently scalable, including the ability to apply ED 01/18 to the audits of entities with a wide range of sizes, complexities and circumstances?
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 01/18 where further guidance is needed in relation to automated tools and techniques, and what is the nature of the necessary guidance?
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?
5. Do the proposals made relating to the auditor’s understanding of the entity’s system of internal control² 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:
 - (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?

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

² Paragraphs 25–44 and A89–A200 of ED 01/18

- (b) Have the requirements related to the auditor's identification of controls relevant to the audit³ 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?
- (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?
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 assessments⁴?
- (b) Do you support the introduction of the concepts and definitions of 'inherent risk factors'⁵ 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?
- (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?
- (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),⁶ and how they assist the auditor in identifying where risks of material misstatement exist?
- (e) Do you support the revised definition,⁷ 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?
7. Do you support the additional guidance in relation to the auditor's assessment of risks of material misstatement at the financial statement level,⁸ including the determination about how, and the degree to which, such risks 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 ASA 330 and its supporting application material? Should either or both requirements be retained? Why or why not?

³ See ED 01/18, paragraphs 39-40 and paragraphs 37-40 of the IAASB's Explanatory Memorandum

⁴ Paragraphs 45-50 and A201-A235 of ED 01/18.

⁵ See paragraph 48 of the IAASB's Explanatory Memorandum and paragraphs 16(f), A5-A6 and A83-A88 of ED 01/18.

⁶ See footnote 26 of the IAASB's Explanatory Memorandum.

⁷ Paragraphs 16(k) and A10, and A229-A231 of ED 01/18.

⁸ Paragraphs 47 and A215-A220 of ED 01/18.

9. Effective date: the IAASB have proposed that the standard will be effective for financial reporting periods commencing on 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?

ED 02/18

10. With respect to the proposed conforming and consequential amendments to:
- (a) ASA 200 (including Appendix 2), ASA 240 and ED 03/18, are these appropriate to reflect the corresponding changes made in proposed ASA 315?
 - (b) ASA 330, are the changes appropriate in light of the enhancements that have been made in proposed ASA 315, in particular as a consequence of the introduction of the concept of general IT controls relevant to the audit?
 - (c) The other ASAs as presented in Appendix 1, are these appropriate and complete?
11. Do you support the proposed revisions to paragraph 18 of ASA 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 ASA 315?
12. Effective Date: the IAASB have proposed that the standard will be effective for financial reporting periods commencing on or after 15 December 2020, which is anticipated to be approximately 18 months after approval of the final ISA 315. Do you think this is sufficient period to support effective implementation of the new standard?

Australian specific questions (for both ED 01/18 and 02/18)

The AUASB is especially interested in stakeholders views on:

13. Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?
14. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
15. Whether there are any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
16. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the main changes to the requirements of the proposed standard? If significant costs are expected, the AUASB would like to understand:
- (f) Where those costs are likely to occur;
 - (g) The estimated extent of costs, in percentage terms (relative to audit fee); and
 - (h) Whether expected costs outweigh the benefits to the users of audit services?

17. What, if any, implementation guidance auditors, preparers and other stakeholders would like the AUASB to issue in conjunction with the release of ASA 315 (specific questions/examples would be helpful).
18. Are there any other significant public interest matters that stakeholders wish to raise?