

Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: Madrid, Spain
Meeting Date: September 11–12, 2017

Agenda Item K

ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* – Report Back and Cover

Project Status – What Have We Done Since We Last Met?

1. Since the March 2017 IAASB CAG meeting, the Task Force has met twice by teleconference and three times in person. **Appendix A** to this paper provides a history of previous discussions with the IAASB CAG and IAASB on this topic, including links to the relevant IAASB CAG documentation.
2. **Agenda Item K.1** outlines the progress the Task Force has made on many of key issues. Where issues outlined in **Agenda Item K.1** relate to matters discussed at the last CAG meeting, the table below includes a cross-reference to the relevant paragraphs in **Agenda Item K.1**.

Feedback - What Did We Hear Last Time We Met?

3. Extracts from the draft minutes of the March 2017 IAASB CAG meeting, as well as an indication of how the Task Force or IAASB has responded to the Representatives' comments, are included in the table below.

Representatives' Comments	Task Force/IAASB Response
OVERALL COMMENT	
Mr. Ilnuma cautioned that consideration should be given to the implementation of the changes if new concepts are introduced.	Point noted. As the changes to ISA 315 (Revised) are developed, the ISA 315 Task Force will continue to consider whether additional guidance, including application guidance, is needed.
GREATER EMPHASIS ON FINANCIAL REPORTING FRAMEWORK WHEN UNDERSTANDING THE ENTITY	
With regard to strengthening the standard for a greater emphasis on the financial reporting framework, Ms. Lang questioned the need for a change to ISA 315 (Revised) as it was likely already considered as part of the auditor's risk assessment procedures. Mr. James questioned the need to separate out considerations relating to the	Ms. Campbell acknowledged that auditors already consider the financial reporting framework in identifying risks of material misstatement, but noted that an enhancement to the standard was needed to help clarify the context of this understanding as it relates to its effect on risk assessment (i.e., what the auditor is measuring against). Furthermore, she noted that the likely

Representatives' Comments	Task Force/IAASB Response
financial reporting framework when understanding the entity, as auditors should be doing that already.	<p>impact would be in how the auditor's consideration of the financial reporting framework and its impact on risk identification is documented.</p> <p>Further details regarding Task Force proposed changes on this topic can be found at paragraphs 36 to 41 of Agenda Item K.1.</p>
Messrs. Stewart, Sobel and Fortin noted support for amending the standard to also focus on the financial reporting framework when considering risks, noting that the audit opinion is expressed in relation to the applicable financial reporting framework and this would therefore help the auditors focus their work. Mr. Stewart added that consideration should also be given to fair presentation frameworks when considering changes in this area, which may also help the auditor identify additional disclosures that may be required and on which the auditor should focus during the audit.	<p>Support noted.</p> <p>Ms. Campbell noted that the Task Force would further consider the impact of fair presentation frameworks.</p>
Mr. James questioned the 'development of expectations' and what this would mean.	<p>Ms. Campbell explained that an emphasis on the applicable financial reporting framework would help develop the auditor's expectations about the financial statements as procedures are undertaken to understand the entity, and noted that the Task Force would consider how to make this clearer.</p> <p>The Task Force is still to develop relevant application material on this topic (as noted in paragraph 41 of Agenda Item K.1).</p>
INHERENT QUALITATIVE RISK FACTORS	
Mr. Kottvedgaard questioned whether aspects of fraud from ISA 240 ¹ would be better placed in ISA 315 (Revised) if fraud was considered one of the inherent qualitative risk factors. He noted the embedded nature of fraud in identifying risks and suggested further consideration be given to how fraud could be better explained in ISA 315 (Revised).	<p>Ms. Campbell acknowledged the iterative interaction between ISA 315 (Revised) and ISA 240 but explained that fraud had been moved into a separate standard to help auditors focus on the various considerations around fraud, and that the intention of changes in this project were not to involve changes to ISA 240 with the exception of conforming amendments as appropriate.</p>

¹ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

Representatives' Comments	Task Force/IAASB Response
	The Task Force has progressed their views on whether the risk of fraud is a qualitative inherent risk factor. Further explanation can be found at paragraphs 24 to 27 in Agenda Item K.1 .
Mr. Sobel supported the addition of fraud as a qualitative inherent risk factor. He noted that although it was a more detailed attribute and not at the principal level, COSO ² had included it in its revised 2013 Framework.	Support noted.
Mr. Yoshii highlighted the importance of using the qualitative inherent risk factors in identifying risks.	Noted. The Task Force has now included the inherent risk factors in the proposed revisions to the standard (see paragraphs 24 to 27 in Agenda Item K.1 and paragraphs 4 and 25A of Agenda Item K.2).
OBTAINING AN UNDERSTANDING OF INTERNAL CONTROL	
Mr. Rockwell questioned what the role of understanding the entity's internal control is when understanding the entity, in particular in relation to identifying inherent risks.	<p>Ms. Campbell explained that understanding the entity's internal control is related to identifying and assessing control risk, and that the Task Force had focused on identifying inherent risks (separately to identifying control risks) to be able to better understand the changes that were needed to be made to the standard to make clear what was needed in respect of inherent risk and control risk. Mr. Koktvedgaard agreed that inherent risk and control risk should be dealt with separately and noted that this was consistent with the audit risk model.</p> <p>At the IAASB meeting in March 2017 (following the CAG meeting), the Board decided that a separate inherent risk and control risk assessment would now be required (i.e. "combined" risk assessments would no longer be allowed). Further details as to how the Task Force has proposed to deal with this "separation" can be found at paragraphs 77 to 85 in Agenda Item K.1.</p>
Mr. Yoshii highlighted the importance of understanding internal control in identifying risks, and noted support for the Task Force's work in this	Support noted.

² Committee of Sponsoring Organizations of the Treadway Commission (COSO)

Representatives' Comments	Task Force/IAASB Response
area. Mr. van der Ende also noted support for the Task Force's work in this area, noting the importance of internal control in audits of financial institutions.	
Mr. Dalkin highlighted the importance of clarifying the relevance of internal control when identifying risks. He added that the role of the auditor and the extent of the work undertaken on internal controls had received greater focus since the COSO Framework was revised in 2013.	Point noted. See Agenda Item K.2 for revisions relating to the clarification of matters as they relate to internal control.
Mr. Dalkin also highlighted that further consideration would need to be given to information technology and its impact on control risk, as greater clarity is needed in the standard.	Ms. Campbell agreed and noted that the Task Force were currently deliberating this area, and that further material would be presented to the IAASB and CAG for discussion at a later meeting. Matters relating to IT will be presented to the IAASB at its October 2017 meeting. Progress on enhancements to requirements and application material relating to IT will be presented to the IAASB CAG Members at its March 2018 meeting.
SIGNIFICANT RISKS AND SPECTRUM OF RISKS	
Messrs. Baumann, Dalkin, Fortin, Inuma, James, Sobel and Ms. Robert supported maintaining the concept of significant risk. Mr. Baumann noted that changes to the definition and guidance were needed and looked forward to the further considerations of the IAASB in relation to significant risk. Mr. Fortin highlighted the need to describe those risks that were on the very high end of the spectrum. Mr. Sobel and Ms. Robert cautioned that the definition, when revised, needed to provide clarity on the difference between a significant risk and a risk of material misstatement.	Support for maintaining the concept of significant risk noted. Ms. Campbell explained that the risk of material misstatement comprised both inherent risk and control risk, but that significant risks related to inherent risks only. She added that further consideration would be given to how this would be made clearer in the standard. Further details regarding Task Force proposed changes on this topic can be found at paragraphs 86 to 87 of Agenda Item K.1 . An updated "working definition" of significant risk can be found at paragraph 4(e) of Agenda Item K.2 .
Mr. Rockwell cautioned about how the term 'significant' is described, as words may be interpreted differently. Mr. Stewart highlighted the importance of consistency in identifying significant risks.	Ms. Campbell agreed and noted the caution. The ISA 315 Task Force has focused on clarifying the definition of 'significant risk' including the auditor taking into account the impact of the qualitative risk factors to assist in its consistent application. As noted above, further details regarding the clarification of the definition of 'significant risk' can

Representatives' Comments	Task Force/IAASB Response
	be found at paragraphs 86 to 87 of Agenda Item K.1 and paragraph 4(e) of Agenda Item K.2 .
Ms. Molyneux questioned how consistency in identifying significant risks could be achieved.	Ms. Campbell acknowledged the concern and explained that it would continue to be up to the auditor's professional judgment as to which inherent risk are identified as significant risks, and added that the Task Force would continue to consider the definition, and related application material, to help auditors in making this judgment.
Mr. Sobel questioned whether identifying significant risk as illustrated by the graph showing likelihood and magnitude was correct. He suggested that its magnitude that makes it significant.	Point noted. Ms. Campbell agreed to further consider this notwithstanding this is how some firms had developed methodologies for identifying significant risks. The Task Force has considered this matter further and debated at length as to whether magnitude alone determines a risk to be significant. Further explanation regarding Task Force proposed changes on this topic can be found at paragraphs 86 to 87 of Agenda Item K.1 .
Messrs. Inuma and Sobel highlighted the need to understand the work effort for those higher risks that were not significant risks.	Point noted. Ms. Campbell explained that further consideration is being given to how the spectrum of risks is described in the revisions to the standard, but noted that the work effort to respond to identified risks is set out in ISA 330, ³ the revision of which is not part of this project with the exception of conforming amendments as appropriate.
Messrs. Rockwell, Sobel and Stewart questioned whether there is still a need for 'significant risk' if the concept of a spectrum of risks is adopted, i.e., how the concept of 'significant risk' would interact with a spectrum of risks. Mr. Rockwell added that it may be difficult to define where the cutoff is between significant risks and other risks. Mr. Stewart noted that the work effort on those risks in a spectrum of risk that were very high would have an increased work effort, and therefore questioned the need for a separate concept.	Point noted. Ms. Campbell explained that the Task Force (and IAASB) had agreed that the concept of significant risk was understood and therefore that it should be retained. However, she acknowledged this point by noting the Task Force and IAASB will continue to consider the concept of significant risks, in particular focusing on revisions intended to make the identification of significant risks more consistent. At the March 2017 IAASB meeting, the IAASB provided a clear direction that the concept of significant risk should be retained with a focus on enhancing the consistency of how this definition is

³ ISA 330, *The Auditor's Responses to Assessed Risks*

Representatives' Comments	Task Force/IAASB Response
	applied. Further explanation regarding Task Force proposed changes on this topic can be found at paragraphs 86 to 87 of Agenda Item K.1 .
Mr. James noted that further clarity was needed on the terms used in a spectrum of risk to make the distinction between the various risks, for example if these are articulated as 'high' or 'higher' or similar. He explained that if there was too much judgment in designating risks, there would be a lack of consistency and ultimately enforceability by regulators.	Point noted. Ms. Campbell acknowledged his concerns and explained that the Task Force was currently considering defining significant risks, and then leaving to firms how they designated other risks, but added that this was still being deliberated by the Task Force.

What Does the ISA 315 Task Force Want Your Views On?

- The IAASB CAG is asked to read **Agenda Item K.1** and provide views on the following matters (matters for CAG Representatives are noted below and are not presented in **Agenda Item K.1**, the questions in that paper are for the upcoming IAASB meeting). In addition, CAG Representatives may find **Agenda Item K.2** helpful in understanding detailed changes being proposed to the requirements in ISA 315 (Revised) as well as the Board decisions/discussions to date. It also outlines the areas of work still to be completed by the Task Force.

Matters for IAASB CAG Consideration

The IAASB CAG is asked for its views on:	
1.	The revised or new definitions (paragraph 4 of ISA 315 (Revised) in Agenda Item K.2) relating to: <ol style="list-style-type: none"> Assertions Controls Internal Control or System of Internal Control Qualitative inherent risk factors Relevant Assertions Relevant classes of transactions, account balances and disclosures Risk Assessment procedures Significant risk
2.	The proposed changes to the overall requirement to obtain an understanding of internal control (paragraphs 47 to 57 of Agenda Item K.1 and paragraph 12 of Agenda Item K.2), in particular whether it is clear that this understanding is gained through identifying controls relevant to the audit within each component, evaluating the design of those controls and determining whether they have been implemented (i.e., paragraph 12 in Agenda Item K.2 ; also see paragraphs 14, 15, 18, 20

and 22 that address understanding each component)?

3. The proposed changes to the requirements for the identification and assessment of the risks of material misstatement, in particular the separation of the requirements relating to the assessment of inherent risk and the assessment of control risk (i.e. paragraphs 25A to 25 D of ISA 315 (Revised) in **Agenda Item K.2**).
4. IAASB CAG Representatives are asked for their views about whether the project is addressing the issues that have been identified (i.e., is there any “scope creep” or are there any proposed changes that go beyond addressing the issues expressed in the Project Proposal (and should therefore not be changed))?
5. Are there any other matters for the ISA 315 Task Force to consider as it further develops the exposure draft of ISA 315 (Revised)?

Material Presented – IAASB CAG Papers

Agenda Item K.1 ISA 315 (Revised) – Issues and Recommendations (IAASB Paper)

Agenda Item K.2 Table of Proposed Changes to ISA 315 (Revised) (IAASB Paper)

Appendix A

Project Details and History

Project: ISA 315 (Revised)

Link to IAASB Project Page: [ISA 315 \(Revised\) Project Page](#)

Task Force Members

The IAASB's ISA 315 (Revised) Task Force comprises:

- Fiona Campbell, IAASB Member and Task Force Chair (supported by Denise Weber, IAASB Technical Advisor)
- Marek Grabowski, IAASB Member (supported by Josephine Jackson, IAASB Technical Advisor)
- Chuck Landes, IAASB Member (supported by Hiram Hasty, IAASB Technical Advisor)
- Susan Jones, IAASB Technical Advisor
- Katharine Bagshaw, International Federation of Accountants Small- and Medium-Sized Practices Committee Member
- Megan Zietsman, IAASB Deputy Chair (correspondent member)

Summary

	IAASB CAG Meeting	IAASB Meeting
Project commencement and preliminary discussions on audit issues relevant to ISA 315 (Revised)	March 2016	March 2016 June 2016
Discussion on the project proposal to revise ISA 315 (Revised)	September 2016	September 2016
Discussion on audit issues and recommendations relevant to ISA 315 (Revised)	September 2016 March 2017	September 2016 December 2016 March 2017

IAASB CAG Discussions: Detailed References

Information gathering	<u>March 2016</u> See IAASB CAG meeting material and meeting minutes (Agenda Item C): http://www.iaasb.org/cag/meetings/paris-france
Project Proposal	<u>September 2016</u> See IAASB CAG meeting material and meeting minutes (Agenda Item D): http://www.iaasb.org/cag/meetings/new-york-usa

Development of Exposure Draft	<p><u>September 2016</u></p> <p>See IAASB CAG meeting material and meeting minutes (Agenda Item D)</p> <p>http://www.iaasb.org/cag/meetings/new-york-usa</p> <p><u>March 2017</u></p> <p>See IAASB CAG meeting material (Agenda Item F)</p> <p>http://www.iaasb.org/cag/meetings/iaasb-cag-meeting</p>
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