

Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: New York, United States of America
Meeting Date: September 10–11, 2019

Agenda Item B

Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement* – Cover and Report Back

Objective of the Agenda Item

1. The objectives of this agenda item are to receive:
 - (a) A report back on comments of the CAG Representatives on this project as discussed at the March 2019 meeting (see Appendix B).
 - (b) Receive a presentation on the ISA 315 Task Force's (the Task Force) views and deliberations on five key areas in progressing to finalization of the proposed International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*.

Project Status

2. At the CAG meeting in March 2019, the Task Force Chair, Fiona Campbell, presented the Task Force's initial thoughts about:
 - How to address the broader issues and concerns in relation to the length, complexity and understandability of Exposure Draft ISA 315 (Revised) (ED–315), and
 - The proposed responses to certain individual issues.

At the March IAASB meeting, concern was expressed about some of the proposals by Board members, and further revisions were made during that meeting, which the Board then asked the Task Force to further apply to the whole standard. The Task Force continued giving significant attention to the complexity, understandability and readability of the standard, while still maintaining the robustness and rigor of the standard, and brought revised proposals to the Board at its June 2019 meeting. The Task Force Chair presented the proposed changes that had been discussed with the Board in June 2019 on a voluntary CAG teleconference on July 10, 2019.
3. The Task Force has continued to develop the standard to finalization, presented in the IAASB papers [Agenda Item's 2-A to 2-D](#) (**Agenda Item 2-E** presents a clean version of the proposed full standard – this has been provided to the CAG as **Agenda Item B.2** and the discussions will focus on this document). These papers present a second full read of the final proposed standard for discussion with the IAASB at its September 2019 meeting, where the approval of the final standard, and its related conforming and consequential amendments, is expected.

4. Since the March 2019 IAASB CAG meeting, the Task Force has met three times in person, three times by teleconference and three times by videoconference.
5. **Appendix A** to this paper provides a history of previous discussions with the CAG and IAASB on this topic, including links to the relevant CAG documentation.
6. **Appendix B** to this paper presents a report-back on the matters discussed with the CAG at the March 2019 meeting.

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

7. The IAASB Agenda Papers will be provided as a reference for the CAG discussions. However, the focus of the discussions with the CAG Representatives will be on the following key areas of the standard:

Focus Area	The IAASB CAG is asked to read the corresponding agenda items, as applicable
Definition of a significant risk.	March 2019 IAASB Meeting, Agenda Item 4 , para. 109–114.
The consideration of ‘ <i>fraud</i> ’ in the definition of the inherent risk factors.	N/A – considerations arose in discussion over definitions in the June 2019 IAASB Meeting, which resulted in a turned definition of inherent risk factors. Minutes to the discussion are in Appendix 2 of Agenda Item B.1.
Distinguishing between the threshold in identifying risk of material misstatement, and the threshold once the auditor determines that a risk of material misstatement exists.	June 2019 IAASB Meeting, Agenda Item 2 , para. 32–38 and indicative drafting
Describing the ‘catch all’ requirement (i.e. paragraph 39(a)(ii) of proposed ISA 315 (Revised)) in the control activities component to identify controls that address risks of material misstatement at the assertion level.	Agenda Item B.1, para. 34(e)
Approval of the final standard and the question about re-exposure.	N/A – will be discussed during the CAG meeting.

Matters for CAG Consideration:

8. The Representatives are asked to provide views on the key areas as listed in paragraph 6, and in particular on whether the Representatives believe there are any fatal flaws that may prevent the standard from being approved by the Board.

Material Presented – IAASB CAG Papers

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| Agenda Item B.1 | ISA 315 (Revised) – Issues and Recommendations (IAASB Paper) |
| Agenda Item B.2 | ISA 315 (Revised) – ISA 315 (Revised) (Clean) |
| Agenda Item B.3 | ISA 315 (Revised) – Presentation |

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)
- Karin French, IAASB Member
- Marek Grabowski, IAASB Member (supported by Josephine Jackson, IAASB Technical Advisor)
- Susan Jones, IAASB Technical Advisor
- Kai Morten Hagan, IAASB 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 for proposed changes to ISA 315 (Revised)	September 2016 March 2017 September 2017 March 2018 September 2018 March 2019	September 2016 December 2016 March 2017 September 2017 October 2017 December 2017 March 2018 June 2018 December 2018 March 2019 June 2019

IAASB CAG Discussions: Detailed References

Information gathering	<p><u>March 2016</u></p> <p>See IAASB CAG meeting material and meeting minutes (Agenda Item C): http://www.iaasb.org/cag/meetings/paris-france</p>
Project Proposal	<p><u>September 2016</u></p> <p>See IAASB CAG meeting material and meeting minutes (Agenda Item D) http://www.iaasb.org/cag/meetings/new-york-usa</p>
Development of Exposure Draft	<p><u>September 2016</u></p> <p>See IAASB CAG meeting material (Agenda Item D) and meeting minutes (Agenda Item C) 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) and meeting minutes (Agenda Item C) http://www.iaasb.org/cag/meetings/iaasb-cag-meeting</p> <p><u>September 2017</u></p> <p>See IAASB CAG meeting material (Agenda Item K) and meeting minutes (Agenda Item C) http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain</p> <p><u>March 2018</u></p> <p>See IAASB CAG meeting material (Agenda Item G) and meeting minutes (Agenda Item A) http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny</p>
Development of Final Standard	<p><u>September 2018</u></p> <p>See IAASB CAG meeting material (Agenda Item J) and meeting minutes (Agenda Item A) http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-0</p> <p><u>March 2019</u></p> <p>See IAASB CAG meeting material (Agenda Item B) and meeting minutes (Agenda Item A) https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-1</p>

Appendix B

Report-Back on Matters Discussed at the March 2019 CAG Meeting

Extracts from the draft minutes of the March 2019 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
Mr. Dalkin acknowledged the work done by the Task Force to address the broader concerns raised by respondents, but expressed concern about the extent of the requirements and application material within the standard, specifically noting that the volume of this material may be interpreted as being too prescriptive, noting that this may be perceived to contradict the objective of 'principle-based' standards. Messrs. Hansen and van der Ende expressed support for the direction of the project.	Support noted.
Messrs. Sobel, Hansen and Van den Ende emphasized the need to keep the standard principles based. These Representatives also noted the complexity that was still in the standard but had the view that by its nature the standard would likely be complex.	Point noted.
Revised Drafting Approach	
Messrs. Dalkin, Sobel, Hansen, Hirai and Ms. McGeachy supported efforts by the Task Force to reduce the length of the standard, and accordingly, when considering the alternative approaches to present the requirements (see Agenda Item 4.A), support was expressed for 'option 2.' However, Mr. Hirai cautioned that if the Board moved forward with the use of definitions as presented then education about how they should be used would be needed.	At the March 2019 IAASB meeting, the Board did not support the use of definitions to support more succinct requirements. Accordingly, the material that had been moved to definitions was reincorporated into the requirements, and the Board further explored how to make the requirements more understandable – as was discussed with CAG Representatives on the July 2019 Teleconference.
Mr. Fortin acknowledged the objective of 'option 2' (as presented in Agenda Item 4.A), but questioned the flow of the standard using this approach. He also noted that there may also be too much upfront which may impact how users of the standard understood the rest of the standard.	Ms. Campbell agreed that this may imbalance the standard, explaining that the Task Force were exploring different ways to enhance the understandability of the standard, but without making it more complex.

Representatives' Comments	Task Force/IAASB Response
	Also see note above – this approach was not progressed.
Mr. Thompson commended the use of definitions to simplify the standard, however noted that although it dealt with complexity it didn't really address scalability.	See note above – this approach was not progressed.
When considering alternatives to reduce the length of the requirements, Mr. James cautioned against the removal of 'requirements' to 'non-authoritative' material, highlighting the need to balance the robustness of the requirements with the desire to reduce length while maintaining understandability. Mr. Hirai also cautioned about maintaining the robustness of the standard while still considering scalability.	Ms. Campbell noted that there is no intention to dilute the robustness of the requirements. Instead, and as presented in option 2, of Agenda Item 4.A , she noted that the Task Force proposed an alternative to help complexity and understandability by using shorter sentences and the use of definitions, adding that the Task Force was very mindful of the need to keep the requirements robust.
Mr. Yoshii expressed caution about the deletion of the detail that was in paragraph 17, noting that this should therefore be appropriately explained within the application material.	Although the detail has been removed from paragraph 17 the requirement to obtain the relevant understanding is still within the requirements – see Agenda Item B.2 paragraph 23 (relating to the understanding of the entity and its environment and the applicable financial reporting framework) and paragraphs 28, 30, 31A, 36 and 39 (relating to the understanding of the components of the system of internal control). In addition, application material has been added in paragraph A89 to explain that the understanding of the system of internal control is obtained through understanding the various components.
Notwithstanding concerns about the extent of explanatory or application material, Ms. McGeachy cautioned against the removal of some existing and very helpful explanatory guidance that is currently included in the application material. It was suggested that this material could be captured in non-authoritative (or similar) guidance material external to the standard.	Point noted. Application material relating to the entity which was seen as helpful has been moved from the application material to the Appendices (which has the same authority) as the IAASB had the view to distinguish these matters from the auditor's considerations when obtaining an understanding was helpful.

Representatives' Comments	Task Force/IAASB Response
Mr. Hansen highlighted that part of the complexity related to the long sentences, and in some cases, the way they were put together, and urged the IAASB to further consider shorter, more succinct sentences. Ms. Zietsman echoed calls for the standard to be shorter but noted that simply making the sentences shorter may impact the understandability of the requirements as it may be more difficult know what to do. However, she also acknowledged that shortening the sentences would make it easier to read. Mr. Pavas also agreed that shorter, principles-based standards were not necessarily easier to use.	Points noted. The Task Force has been mindful of making sentences more understandable and shorter where appropriate.
Ms. Zietsman cautioned that option 2, as presented in Agenda Item 4.A , will only be effective if auditors appropriately understand the relevant definitions or principles, and therefore a fine balance remains between a principle and providing guidance to explain such principle in practical terms. Ms. Zietsman also agreed that the application material includes helpful explanatory guidance, however, in some areas, the extent thereof may exceed the objective or scope of application material as described in ISA 200. ¹ Ms. Zietsman supported the suggestion to include some of this guidance in non-authoritative guides external to the standard.	Point noted – see note above regarding new approach not being progressed. With regard to the application material, significant efforts have been made to rebalance the application material to what is appropriate to support the application of the requirements.
Mr. Koltvedgaard supported an emphasis on the purpose of each requirement, however, he cautioned against this being a separate consideration within the requirement – the purpose should be evident when considering the requirement itself. He noted that clear and concise requirements may reduce the extent of application material that is required.	Ms. Campbell explained that this was the intent of the Task Force, i.e., to integrate or present the purpose of the required procedures into each requirement. As an example, Ms. Campbell referred to the proposed revisions to paragraph 17 of ED-315 (Agenda Item 4.A).
Messrs. Koltvedgaard, Pavas and Dalkin, and Ms. McGeachy emphasized the need for guidance. Ms.	Ms. Campbell agreed, and noted that the Task Force would explore what guidance was needed to

¹ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

Representatives' Comments	Task Force/IAASB Response
Zietsman further emphasized the importance of guidance to support principles-based standards.	support the proper application of the revised standard.
Scalability	
Mr. James noted that scalability is equally as important as complexity, and therefore that this had to be a focus as the standard is finalized. Mr. Hirai noted that the issue of scalability could be covered in the application material.	Ms. Campbell fully agreed with these observations and acknowledged that scalability and complexity are both seen as a priority by the Task Force. Ms. Campbell further noted that in the view of the Task Force, scalability cannot be fully addressed within the requirements. Instead, the intention of the Task Force is to address scalability in the application material where appropriate, and outside of the standard through the use of educational material such as non-authoritative guidance or frequently asked questions.
Mr. Van den Ende cautioned the Task Force against making changes that may not sufficiently address the more complex situation auditors may encounter, emphasizing the need to be to scale up for more complex situations where necessary.	Point noted. In revising the application material, where appropriate, the Task Force has added examples to illustrate the scaling up concept (for example, see examples in Agenda Item B.1 paragraphs 16a and A73a (in example boxes below).
Audits of Less Complex Entities	
Messrs. Van den Ende and Fortin both commented on the interaction of the changes being made to ISA 315 (Revised) and the work that would be done in project related to Audits of Less Complex Entities (LCEs), highlighting the importance of clarity about how they would interrelate.	Ms. Campbell noted that often work done in one project informs the work of another project, which is the case in this instance. She highlighted that ISA 315 (Revised) could not be held up for work to be progressed in relation to audits of LCEs, but noted that the discussions about the way that ISA 315 (Revised) is drafted will inform the deliberations in relation to audits of LCEs.
Understanding the System of Internal Control	
Mr. Sobel acknowledged the Task Force's efforts to align the system of internal control with the COSO Internal Control – Integrated Framework. ²	Support noted.

² Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Internal Control – Integrated Framework*

Representatives' Comments	Task Force/IAASB Response
<p>Mr. van der Ende fully supported the clarifications relating to the design and implementation of controls (D&I), highlighting the importance and benefit to auditors of these procedures, even when undertaking a fully substantive audit approach. Although Mr. Thompson supported the clarifications, he questioned whether the extent of the required work effort where an entity has limited controls is clear.</p>	<p>Ms. Campbell agreed that this area remains a challenge as there may be larger entities with simple systems of internal control that may be audited through substantive procedures only. However, she highlighted that this concept supports the notion that scalability, and therefore the extent of D&I procedures largely depends on the degree of complexity (as opposed to size of an entity) and the Task Force believes this can be demonstrated through the use of examples.</p> <p>With regard to the work effort, additional application material has been added in Agenda Item B.1 paragraphs A15e and A16 to explain the judgmental nature of the extent of work that may be needed.</p>
<p>Ms. Zietsman highlighted the importance of examples to demonstrate the importance of controls in situations where substantive procedures alone are not enough.</p>	<p>Point noted – the IAASB will consider how guidance to support the implementation of ISA 315 (Revised) can focus on examples of controls in situations where substantive procedures alone are not enough.</p>
<p>Mr. Fortin questioned whether there was a difference between a 'system' and 'technology,' and why the latter term was not used. In addition, he questioned whether other recent developments (such as block chain) were considered by the Task Force when drafting the proposals.</p>	<p>Ms. Campbell responded by explaining that the terminology as proposed is compliant with the COSO framework, and even though the standard intends to be framework neutral, the COSO framework is generally accepted and understood by auditors. In response to recent developments such as block chain, Ms. Campbell noted that the Task Force was cautious not to include specific examples of technology, as this in itself may date the standard once new technologies emerge. Nonetheless, the standard requires the auditor to consider how the entity utilizes information technology and consequently, the auditor has to consider risks that may arise through the use of information technology (IT).</p>
<p>Mr. Sobel highlighted that an entity's internal audit department generally has an intimate understanding of an entity's system of internal control. Given this knowledge, Mr. Sobel questioned whether it would be useful to explicitly</p>	<p>Point noted – the Task Force considered whether more is needed in ISA 315 (Revised) (regarding considerations about the use of the entity's internal</p>

Representatives' Comments	Task Force/IAASB Response
require the auditor to consult with the entity's internal audit department, if applicable, when obtaining an understanding of the entity's system of internal control. Mr Sobel acknowledged that the standard does include other responsibilities in relation to the internal audit function, and in particular when obtaining an understanding of the entity's process to monitor the system of internal control.	audit function, but on balance agreed that ISA 610 ³ sufficiently covers the auditor's considerations in relation to the use of the entity's internal audit function and that the matters already contained within ISA 315 (Revised) are sufficient.
Sufficient and Appropriate Audit Evidence	
Recognizing that the term 'sufficient and appropriate audit evidence' is generally associated with the relevance and reliability of audit evidence in drawing conclusions on which to base the auditor's opinion, Messrs. Dalkin, Fortin, Ruthman and James supported the proposed change.	Support noted.
Ms. Zietsman supported the change noting that the initial proposal could lead to some confusion as it may lead to interpretations that risk assessment procedures alone may be sufficient in addressing risks of material misstatement. She further noted that notwithstanding that risk assessment procedures do provide audit evidence, they are used as the basis for determining further audit procedures to reduce audit risk to an acceptable level.	Support noted.
Mr. Hansen noted that auditors are familiar with the term 'sufficient and appropriate audit evidence' and therefore the proposed revision may be confusing.	Point noted. No further change proposed.
Mr. Van der Ende opposed the proposed change, as he believed the auditor should always aim to obtain 'sufficient and appropriate audit evidence,' no matter the context.	Point noted. No further change proposed.
Susceptibility to Fraud as an Inherent Risk Factor	
Messrs. Koktvedgaard and Sobel noted that fraud is integral to the risk assessment process and due	Ms. Campbell thanked the Representatives for their views, and noted that there appeared to be

³ ISA 610 (Revised), *Using the Work of Internal Auditors*

Representatives' Comments	Task Force/IAASB Response
to its inherent risk attributes, it should continue to be included as an IRF.	consensus that fraud has to be appropriately emphasized during the risk assessment process, although not necessarily as an IRF. Ms. Campbell also reminded the CAG of the many references to fraud already within ISA 315 (Revised) (as was noted in the Explanatory Memorandum to ED-315 and was supported by the Board), and also further highlighted that there is a separate standard on the auditor's specific considerations relating to fraud therefore that ISA 315 (Revised) was not intended to cover all aspects of the auditor's considerations regarding fraud.
Ms. Zietsman noted that the output of the risk assessment process is the determination of risks of material misstatement, and these may be due to fraud or error. Ms. Zietsman therefore expressed concern that it may be confusing if the consideration of fraud is treated as both an input to the risk assessment process as well as an output. Accordingly, in her view, fraud by itself does not necessarily belong as an IRF. Instead, and with appropriate emphasis on the risk of fraud and references to ISA 240 ⁴ the IAASB could consider including the risk of or susceptibility to intentional or unintentional manipulation. In doing so, the auditor would reach the same conclusion, irrespective whether 'fraud' is included as an IRF or otherwise. Mr. Koktvedgaard and Ms. Hansen supported this conclusion.	See above
Mr. van der Ende highlighted the importance of public interest aspects of fraud, noting the importance of cross-referencing between the ISAs, in particular between ISA 315 (Revised) and ISA 240. Mr. Dalkin encouraged the Board to give more recognition to fraud more generally within the standard.	See above

⁴ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

Representatives' Comments	Task Force/IAASB Response
Reasonable Possibility of Misstatement and More Than Remote	
Although supportive of the threshold of 'reasonable possibility,' strong support was expressed for the proposal to remove the term 'more than remote' from the definition of 'relevant assertions' by Ms. Robert and Messrs. Hansen and Dalkin.	Support noted.
Definition of Significant Risk	
Mr. Sobel acknowledged the responses to ED-315 in relation to the term 'likelihood or magnitude' in the definition of significant risk. However, Mr. Sobel noted that in his view, there may be circumstances where both criteria are not necessarily required to justify the determination of a significant risk. Accordingly, he expressed concern with the proposed revision. Messrs. van der Ende and Fortin expressed the same concern, noting that either criteria could trigger a significant risk.	Ms. Campbell responded that, in the view of the Task Force, the reason for identifying significant risks relates to the auditor's response to those risks, which is a greater work effort than if it is not determined to be a significant risk. However, with the introduction of the concept of a 'spectrum of risk,' the revisions in the standard still drive the auditor to an increased response (i.e., work effort) to address a risk that is higher, regardless of if it is designated as a significant risk or not. She also emphasized the judgmental nature of the decisions to be made regarding whether a risk is designated a significant risk or not. Ms. Campbell also reminded Representatives that respondents to ED-315 expressed significant concerns that a scenario where the risk of material misstatement has a really low likelihood, but high magnitude, was interpreted to mean that there was always a significant risk, and the Task was therefore trying to address those concerns.
Mr. Yoshii expressed support for the proposal to change the term to 'likelihood and magnitude,' however, he noted that the auditor should be able to apply discretion or professional judgment under the particular circumstances. Mr. Yoshii provided an example of natural disasters in Japan where the likelihood may be perceived to be low, however, it remains possible and does occur from time to time. Mr. Hirai supported this view that there may be circumstances, based on the auditor's professional judgment, where there may be a significant risk based on low likelihood but high magnitude.	See above

Representatives' Comments	Task Force/IAASB Response
<p>Ms. Robert supported the notion that the determination of a significant risk includes an element of subjectivity and suggested that the standard should emphasize that professional judgement should be applied by the auditor.</p>	<p>See above</p>
<p>Stand-Back Requirements</p>	
<p>Ms. Zietsman noted that the stand-back in ED-315 may be redundant, although she is aware that there were mixed views in response to this question in ED-315. Mr. Dalkin supported the view that the stand-back in ED-315 may be redundant.</p>	<p>Point noted. The responses to ED-315 were mixed, and on balance the IAASB agreed to maintain the stand-back in ISA 315. No further change proposed.</p>