

**Meeting:** IAASB Consultative Advisory Group (CAG)  
**Meeting Location:** New York, United States of America  
**Meeting Date:** March 6–7, 2018

# Agenda Item G

## **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 September 2017 IAASB CAG meeting, the Task Force has met three times by teleconference, once by videoconference 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 G.1** outlines the progress the Task Force has made on many of the key issues. Where issues outlined in **Agenda Item G.1** relate to matters discussed at the last CAG meeting, the table below includes a cross-reference to the relevant paragraphs in **Agenda Item G.1**.  
**Agenda Item G.2:** ISA 315 (Revised) – Proposed Changes to the Requirements  
**Agenda Item G.3:** ISA 315 (Revised) – Proposed Changes to the Application Material

### **Feedback - What Did We Hear Last Time We Met?**

3. Extracts from the draft minutes of the September 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
<b>DEFINITIONS</b>	
Mr. Fortin cautioned about the use of 'significant' in the definition of business risk, noting that this may be confused with the use of the word in 'significant risk.'	Point noted. This term is currently used in extant ISA 315 (Revised) and has not been identified as problematic.
<b>DEFINITION OF INTERNAL CONTROL</b>	
Mr Koktvedgaard questioned the use of the term 'to provide reasonable assurance,' in the context that this was an audit term and there was no requirement for management to provide 'reasonable assurance.'	Point noted. However, this is used in the extant standard (as well as other widely accepted internal control frameworks) in relation to the system of internal control. An effective system of internal control provides management (or those charged

Representatives' Comments	Task Force/IAASB Response
	with governance) with some assurance regarding achieving the entity's objectives – the use of the term "reasonable assurance" over "absolute assurance" acknowledges the limitations a system of internal control may have.
Mr. Yoshi noted that the Japanese framework for internal control included six components.	Ms. Campbell explained that the five components proposed are consistent with the extant ISAs and other commonly used internal control frameworks.
Mr. van der Ende questioned whether there is still opportunity to further explore the definition of internal control, as he believes the definition should clarify the difference between management's view about its control objectives versus the way the external auditor views controls.	Point noted. The definition of the system of internal control sets out the components of internal control (and emphasizes that these are management's responsibility). The auditor's consideration of controls includes understanding management's approach to the five components and then identifying the controls that are relevant to the audit. The criteria for such controls can be found in the requirements of ISA 315 (Revised).
DEFINITION OF CONTROLS	
Mr. Fortin expressed concern that the revised definition of controls may be circular as it referred to 'control objectives.'	Point noted. In the view of the Task Force, controls are put in place to achieve an objective of the entity, and therefore it is an integral part of the definition.
DEFINITION OF ASSERTIONS AND RELEVANT ASSERTIONS	
Messrs. Yurdakul and Hansen questioned the removal of the wording "management representations" from the extant definition of "assertions."	Ms. Campbell explained that this had been removed as it had been noted that there was confusion between management representations made generally with those more formally required by the ISAs (say by ISA 580). <sup>1</sup>  The definition has been further revised to make this clear – see <b>Agenda Item G.2 Paragraph 4(aa)</b>
Mr. Bradbury encouraged the Task Force to reconsider the complexity of the language now used to describe the assertions.	Point noted. The definition has been further revised to make this clear – see <b>Agenda Item G.2 Paragraph 4(aa)</b>
Mr. Hansen noted that there may be a circular reference in the definition of "assertions," and specifically with respect to the notion of "needs." The wording "need" or "needs" appears in both the first and second sentences of the proposed	Point noted – this has now been deleted – see <b>Agenda Item G.2 Paragraph 4(aa)</b>

<sup>1</sup> ISA 580, *Management Representations*

Representatives' Comments	Task Force/IAASB Response
definition. In addition, he noted the definition refers to “materiality” and the context thereof may require clarification.	
Mr. Yurdakul questioned whether the Task Force considered the term “significant assertions,” as opposed to the proposed wording of “relevant assertions.”	Point noted. The Task Force has used ‘relevant’ assertion to distinguish this concept from ‘significant’ classes of transactions, account balances or disclosures, and ‘significant’ risks. It should also be noted that the use of this term is consistent with other commonly used auditing standards — different terms for the same concept may result in confusion.
<b>DEFINITION OF QUALITATIVE INHERENT RISK FACTORS (QIRFS)</b>	
Messrs. Koktvedgaard, Ruthman and Fortin expressed their concern with the removal of the “susceptibility to the risk of fraud” (risk of fraud) as a QIRF.	<p>Ms. Campbell noted that this has been debated significantly by the Task Force but added that further consideration would be given to whether the susceptibility to fraud should be included as a QIRF.</p> <p>The Task Force has further deliberated this matter and it was added back for discussion at the December 2017 IAASB meeting. In furthering considering this to respond to concerns raised by the IAASB, the Task Force has more broadly described this QIRF as ‘susceptibility to management bias’ and further explained that this could include fraud. See further discussion in <b>Agenda Item G.1, paragraphs 22–24</b></p>
Ms. Meng cautioned that there is a fundamental and underlying distinction between inherent risk and the risk of fraud. She noted that whereas inherent risk is deemed to be present regardless of the circumstances (de facto), the risk of fraud is driven by an act of intention to commit the fraud.	Point noted - the Task Force has more broadly described this QIRF as ‘susceptibility to management bias’ and further explained that this could be unintentional or intentional, which would include fraud. See further discussion in <b>Agenda Item G.1, paragraphs 23–24</b>
Mr. Hussein suggested that ‘judgment’ be included in the definition of a QIRF, as the application of judgment is generally prone to risks of material misstatement. Mr. Fortin supported this comment, in particular as it would be consistent with the principles of ISA 540.	Ms. Campbell explained that the use of QIRF’s would be further explained in the application material. In the Task Force’s further coordination with the ISA 540 Task Force, it was agreed that “subjectivity” would be the term used in both standards. – <b>See Agenda Item G.1, paragraph 19</b>
Mr. Fortin further emphasized the importance to properly define the QIRFs, as there may be	Point noted. The Task Force has continued to deliberate the aspects of the QIRF’s to be included

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uncertainty in the interpretation thereof by the auditor.	- See further discussion in <b>Agenda Item G.1, paragraphs 18–25</b>
DEFINITION OF SIGNIFICANT RISKS	
Messrs. Van der Ende and Fortin questioned whether the revised definition for significant risks was sufficient to identify all significant risks, in particular where there was an obvious significant risk.	Point noted. The Task Force has continued to refine the definition of significant risk, as well as the requirements for the auditor's assessment of inherent risk—See <b>Agenda Item G.1, paragraphs 30–32</b> .
Mr. Baumann expressed concern that the revised definition no longer referred to the auditor's response (previously had referred to that significant risks would require 'special audit consideration.') Mr. Fortin supported the change as the response should not be dealt with in the definition.	Ms. Campbell agreed with Mr. Fortin and noted that the meaning of 'special audit considerations' was not clear and had therefore been removed. The Task Force has also agreed to enhance the application material to reference where specified ISA's require specific responses when significant risks are identified – see <b>Agenda Item G.3, paragraph A144a</b>
Mr. Fortin questioned the use of 'higher' in the definition, and noted that this may be interpreted differently, and suggested rearticulating in terms of the spectrum of risk.	Point noted – the revised definition now includes that a significant risk is a risk at the 'highest end of the spectrum of inherent risk' – see <b>Agenda Item G.2, paragraph 4(e)</b>
Mr. Ilnuma noted that the first part of the definition of a 'significant risk' referred to the QIRFs, and noted that the definition may be misunderstood and interpreted as qualitative risk factors (only) in the general sense.	Ms. Campbell noted that further consideration would be given how to clarify this in the application material. The definition has now been clarified and in light of the task force changes to the definition of QIRFs to be "inherent risk factors," which includes quantitative factors - see <b>Agenda Item G.2, paragraph 4(e)</b>
DEFINITION - OTHER	
Mr. Koktvedgaard noted the various references in the proposed Standard to "inherent risk" and questioned whether it should not also be defined in ISA 315 (Revised).	Ms. Campbell noted that "inherent risk" is already defined in the ISAs as part of the risk of material misstatement. This definition is now included in the introduction section of the standard. See <b>Agenda Item G.2 paragraph 1B</b>
Mr. Dalkin questioned whether IT environment should be defined.	Point noted. On further reflection with regard to matters related to IT, the Task Force has included existing definitions for "application controls in information technology" (see <b>Agenda Item G.2, paragraph 4(a)</b> ) and "general IT controls" (see <b>Agenda Item G.2, paragraph 4(caa)</b> )

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<b>IDENTIFICATION AND ASSESSMENT OF RISK OF MATERIAL MISSTATEMENT</b>	
Messrs. van der Ende, Fortin and Ms. Meng strongly supported the separation of the assessment of inherent risk and control risk. Mr. Fortin suggested the development of a decision tree to illustrate the process for these assessments.	Support noted. Further consideration will be given to the implementation of the standard, including whether or not developing a flow chart or decision tree would prove helpful.
Mr. Dalkin questioned how precluding a 'combined' risk assessment by requiring a separate assessment for inherent and control risk would change practice. Although supporting the change, Mr. Inuma asked for further clarification for the change.	Ms. Campbell explained that this change had been made to provide clarity about what needed to be done for each of the relevant assessments, but in practice some of the procedures are carried out simultaneously and was therefore not expected to significantly impact how the assessments were done. Ms. Campbell further explained that the proposed change was driven primarily by the concerns by some who believe that auditors may take credit for, or place reliance on, controls during the risk assessment process without testing those controls. She noted that the separation of the assessment of inherent risk and control risk is expected to clarify the auditor's considerations around control risk.
Ms. Meng noted a subtle difference in the wording of the proposed paragraph 25C compared to the wording included in the staff paper (Report back – Agenda Item K): The proposed paragraph read "...and determine <u>that</u> they have been implemented." In contrast, the staff paper read "...and determine <u>whether</u> they have been implemented."	Ms. Campbell acknowledged the difference in wording, but noted that the context or meaning of the sentence remains the same and appropriate. She added that the proposed paragraph is consistent with the extant Standard, it was just moved from extant paragraph 29.
<b>OTHER MATTERS</b>	
Mr. Yoshi emphasized the need for a proper understanding of the industry and business model, in particular for small and medium entities, in order to undertake an effective identification and assessment of risks of material misstatement.	Ms. Campbell agreed and noted that further changes were being made in the application material regarding business model to emphasize the kinds of matters that needed to be understood. (see <b>Agenda Item G.3, paragraphs A31e–A31f</b> )

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

4. The IAASB CAG is asked to read **Agenda Item G.1** and provide views on the matters for CAG Consideration therein. **Appendix X to Agenda Item G.1** presents matters presented to the IAASB

in October 2017 relating to information technology (IT) considerations. The Task Force continues to work through the changes relating to IT, and will continue to do so until finalization of the Exposure Draft in June 2018. **Agenda Item G.1** also outlines the areas of work still to be completed by the Task Force.

5. CAG Representatives may find **Agenda Items G.2** and **G.3** helpful in understanding detailed changes being proposed to the requirements and application material in ISA 315 (Revised) to date.

**Material Presented – IAASB CAG Papers**

<b>Agenda Item G.1</b>	ISA 315 (Revised) – Issues and Recommendations (IAASB Paper)
<b>Agenda Item G.2</b>	ISA 315 (Revised) – Proposed Changes to ISA 315 (Revised) Requirements (Marked to Extant)
<b>Agenda Item G.3</b>	ISA 315 (Revised) – Proposed Changes to ISA 315 (Revised) Application Material (Marked to Extant)

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

**Summary**

	<b>IAASB CAG Meeting</b>	<b>IAASB Meeting</b>
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	September 2016 December 2016 March 2017 September 2017 October 2017 December 2017

**IAASB CAG Discussions: Detailed References**

Information gathering	<p><u>March 2016</u> See IAASB CAG meeting material and meeting minutes (Agenda Item C): <a href="http://www.iaasb.org/cag/meetings/paris-france">http://www.iaasb.org/cag/meetings/paris-france</a></p>
Project Proposal	<p><u>September 2016</u> See IAASB CAG meeting material and meeting minutes (Agenda Item D) <a href="http://www.iaasb.org/cag/meetings/new-york-usa">http://www.iaasb.org/cag/meetings/new-york-usa</a></p>
Development of Exposure Draft	<p><u>September 2016</u> See IAASB CAG meeting material (Agenda Item D) and meeting minutes (Agenda Item C) <a href="http://www.iaasb.org/cag/meetings/new-york-usa">http://www.iaasb.org/cag/meetings/new-york-usa</a></p> <p><u>March 2017</u> See IAASB CAG meeting material (Agenda Item F) and meeting minutes (Agenda Item C) <a href="http://www.iaasb.org/cag/meetings/iaasb-cag-meeting">http://www.iaasb.org/cag/meetings/iaasb-cag-meeting</a></p> <p><u>September 2017</u> See IAASB CAG meeting material (Agenda Item K) and meeting minutes (Agenda Item C) <a href="http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain">http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain</a></p>