

# Agenda Item 3-C (for reference)

This agenda item presents changes to the requirements, marked to the version presented to the December 2017 IAASB meeting. This agenda item supplements agenda Item 3-A, which presents the proposed requirements marked to extant.

## ISA 315 (Revised)<sup>1</sup>

### Title

## Identifying and Assessing the Risks of Material Misstatement

### Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements.

### Risks of Material Misstatement

- 1A. ISA 200 deals with the overall objectives of the auditor, including to obtain sufficient appropriate audit evidence to reduce audit risk, which is a function of the risks of material misstatement and detection risk,<sup>2</sup> to an acceptably low level. ISA 200 explains that the risks of material misstatement may exist at two levels: the overall financial statement level; and the assertion level for classes of transactions, account balances and disclosures. Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence.<sup>3</sup>
- 1B. ISA 200 explains that the risks of material misstatement at the assertion level consist of two components: inherent risk and control risk; and that they are the entity's risks and exist independently of the audit of the financial statements:<sup>4</sup>
  - Inherent risk is defined as the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.<sup>5</sup>
  - Control risk is defined as the risk that a misstatement that could occur in an assertion about a class of transactions, account balance or disclosure and that could be material, either

<sup>1</sup> International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.

<sup>2</sup> ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing, Paragraphs 5, A34

<sup>3</sup> ISA 200, paragraphs A36-A38

<sup>4</sup> ISA 200, paragraph A39

<sup>5</sup> ISA 200, paragraph 13(n)(i)

individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's [system of]<sup>6</sup> internal control.<sup>7</sup>

- 1C. Inherent risk is influenced by factors that, alone or in combination with others, increase, to varying degrees, the susceptibility of an assertion about a class of transactions, account balance or disclosure to a misstatement that could be material. Depending on the extent to which the assertion is subject to, or affected by, such factors, the level of inherent risk varies, for different risks of material misstatement at the assertion level, on a continuous scale. For example, ISA 200 explains that inherent risk is higher for some assertions about particular classes of transactions, account balances and disclosures than for others.<sup>8</sup> In this ISA, this continuous scale of inherent risk is referred to as the 'spectrum of inherent risk.'
- 1D. Significant risks are risks of material misstatement for which the inherent risk, is at the highest end of that spectrum, relative to other risks of material misstatement in a particular audit.
- 1E. ISA 200 also explains that an audit in accordance with the ISAs is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit.<sup>9</sup> This includes responsibility for such internal control as management and, where appropriate, those charged with governance, determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of internal control.<sup>10</sup>
- 1F. In this ISA, the auditor obtains an understanding of the entity's system of internal control, through understanding each of the components of internal control, as part of the required basis for the auditor's identification and assessment of the risks of material misstatement in the financial statements (including control risk). The auditor's assessment of control risk at the assertion level involves taking into account whether the auditor's further audit procedures involve planned reliance on the operating effectiveness of controls,<sup>11</sup> and the extent to which the controls addresses the assessed inherent risks at the assertion level.
- 1G. This ISA requires a separate assessment of inherent risk and control risk. These risk assessments are combined to give rise to the auditor's assessment of risks of material misstatement at the assertion level. Accordingly, like inherent risk, the assessed risk of material misstatement at the assertion level varies, for different risks, on a continuous positive scale. The position of an individual risk on this 'spectrum of risk of material misstatement' is lower than its position on the spectrum of inherent risk, when the auditor intends, or is required, to test the operating effectiveness of controls relevant to the audit related to that risk. However, the position of an individual risk on the spectrum of risk of material misstatement is the same as its position on the spectrum of inherent risk, when the

---

<sup>6</sup> Square brackets [xx] indicate that a conforming amendment will be needed

<sup>7</sup> ISA 200, paragraph 13(n)(ii)

<sup>8</sup> ISA 200, paragraph A40

<sup>9</sup> ISA 200, paragraphs 4 and A2

<sup>10</sup> ISA 200, paragraph A41; Appendix 3 also sets out limitations of internal control

<sup>11</sup> ISA 330, *The Auditor's Responses to Assessed Risks*, paragraph 7-8

auditor does not intend, and is not required, to test the operating effectiveness of any controls that are related to the risk.

### **Scalability of the Auditor's Risk Assessment Procedures**

1H. The auditor's risk assessment procedures to identify and assess the risks of material misstatement will vary depending on:

- The nature and complexity of the entity and its environment, which affects the nature and extent of the transactions, other events and conditions that give rise to, or affect the recognition, measurement, presentation or disclosure of, significant classes of transactions, account balances and disclosures in the financial statements;
- The degree to which applying the requirements of the applicable financial reporting framework to such classes of transactions, account balances and disclosures is subject to, or affected by, inherent risk factors; and
- The nature and complexity of the entity's system of internal control relevant to financial reporting.

For example, for an entity with a simple business model and business processes and a non-complex information system, the nature and extent of risk assessment procedures will likely be less than that for an entity that has a complex business model or processes supported by a complex information system.

1I. The auditor's risk assessment procedures will also vary based on the extent of controls that are determined to be relevant to the audit. The volume of controls relevant to the audit increases when the auditor plans to take into account the operating effectiveness of controls in designing the further audit procedures to be performed. Further, the extent of complexity in the entity's IT environment and the nature and extent risks arising therefrom also affect the extent of controls likely to be relevant to the audit, both in terms of application controls and general IT controls. When the entity's IT environment is simple, for example when an entity uses packaged software with limited or no modifications, there may be very few general IT controls relevant to the audit.

### **Addressing Identified and Assessed Risks of Material Misstatement Through Overall Responses and Further Audit Procedures**

1J. ISA 330<sup>12</sup> deals with both the auditor's design and performance of further audit procedures at the assertion level, whose nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level, and the design and implementation of overall responses to the risks of material misstatement at the financial statement level.<sup>13</sup> ISA 330 also explains that in designing further audit procedures, consideration is given to the reasons for the assessment given to the risks of material misstatement. These reasons include:

- (a) The characteristics of classes of transactions, account balances and disclosures (i.e. inherent risk factors). For example, understanding that a reason for the assessment given to a particular risk related to the valuation assertion for an asset is that its measurement is subject to estimation uncertainty, a principal source of which is an assumption about management's intent

<sup>12</sup> ISA 330, paragraphs 6–7

<sup>13</sup> ISA 330, paragraph 5

to take a particular course of action, may assist the auditor in designing further audit procedures that are responsive to that reason by seeking audit evidence that could be evaluated to corroborate or contradict management's stated intent.

- (b) That the auditor has assessed control risk at the assertion level to be less than maximum. For example, the auditor's evaluation of the design of the specific controls that have been taken into account in reducing the assessment of control risk from the maximum, and whether they were implemented, assists the auditor in designing and performing tests of the operating effectiveness of those specific controls.

1K. ISA 330 also deals with the persuasiveness of audit evidence required to address the auditor's assessments of risk – the higher the auditor's assessment of the risk of material misstatement at the assertion level is, the more persuasive the audit evidence the auditor needs to obtain is.<sup>14</sup> Obtaining more persuasive audit evidence ordinarily involves greater audit effort.

### Effective Date

2. This ISA is effective for audits of financial statements for periods ending on or after December 15, 20xx.

### Objective

3. The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

### Definitions

4. For purposes of the ISAs, the following terms have the meanings attributed below:
- (a) Application controls in information technology – Manual or automated procedures that typically operate at a business process level. Application controls can be preventative or detective in nature and are designed to ensure the integrity of the accounting records. Accordingly, application controls relate to procedures used to initiate, record, process and report transactions or other financial data.
- (aa) Assertions – Representations ~~by management, explicit or otherwise~~, with respect to the recognition, measurement, presentation and disclosure of information in the financial statements. Such representations, which may be explicit or implicit, are inherent in management representing that the financial statements are in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying and assessing the risks of material misstatement. (Ref. Para: A0a)
- (b) Business risk – A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.
- (c) *Internal control: See 4(f) below – now "System of Internal Control"*

---

<sup>14</sup> ISA 330, paragraph 7(b)

- (ca) Controls – Policies or procedures that are embedded within the components of the system of internal control to achieve the control objectives of management or those charged with governance. In this context:
- Policies are ~~formal statements that are documented or otherwise communicated by management or those charged with governance, or informal expectations implied through their actions, as to~~ of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications or implied through actions and decisions.
  - Procedures are actions to implement policies. (Ref: Para. A0b–A0c)
- (caa) General IT controls – Policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. General IT controls commonly include controls over data center and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development and maintenance.
- (cb) ~~Qualitative~~ Inherent Risk Factors – Characteristics of events or conditions that affect susceptibility to misstatement of an assertion about ~~relating to~~ classes of transactions, account balances or disclosures, before consideration of controls that impact their susceptibility to misstatement at the assertion level. Such ~~factor~~ characteristics may be qualitative or quantitative. Qualitative factors include complexity, ~~ambiguity,~~ subjectivity, change, uncertainty and susceptibility to ~~management bias~~ fraud. (Ref: Para A0d-A0g)
- (cc) Relevant assertions – An assertion is relevant to a class of transactions, account balance or disclosure when the nature or circumstances of that item are such that there is a reasonable possibility of occurrence of that a misstatement with respect to that assertion that is ~~of the item may occur and be~~ material, individually or in combination with other misstatements, with respect to that assertion. There is such possibility when the likelihood of a material misstatement is more than remote. The determination of whether an assertion is a relevant assertion is made before consideration of controls. (Ref: Para. A0e)
- (d) Risk assessment procedures – The audit procedures designed and performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
- (da) Significant class of transactions, account balance or disclosure – A class of transactions, account balance or disclosure for which there is at least one or more relevant assertions.
- (e) Significant risk – An identified risk of material misstatement:
- For which the assessment of inherent risk, is at the highest end of the spectrum of inherent risk due to the ~~degree~~ impact of which one or a combination of the ~~qualitative~~ inherent risk factors affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should that misstatement occur; or
  - That is to be treated as a significant risk in accordance with the requirements of other ISAs.<sup>15</sup> (Ref: Para. A0h)

<sup>15</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 27 and ISA 550, *Related Parties*, paragraph 18

- (f) System of Internal Control (*Previously (c) Internal Control*)— The system designed, implemented and maintained by those charged with governance, management and other personnel, to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. For the purposes of the ISAs, the system of internal control consists of five inter-related components: (Ref: Para. A019)
- Control environment.
  - The entity's risk assessment process.
  - The entity's process to monitor the system of internal control.
  - The information system and communication.
  - Control activities.

## Requirements

### Risk Assessment Procedures and Related Activities

5. The auditor shall design and perform risk assessment procedures to obtain an understanding of:
- The entity and its environment ~~(in accordance with~~ see paragraph 11(a));
  - The applicable financial reporting framework ~~(in accordance with~~ see paragraph 11(b)); and
  - The entity's system of internal control ~~(in accordance with~~ see paragraphs 12–21 ~~BA~~)
- ~~in order~~ to provide ~~a~~ sufficient ~~and~~ appropriate audit evidence~~basis~~ for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Ref: Para. A1–A35)
6. The risk assessment procedures shall include the following: (Ref: Para A4a–A5)
- (a) Inquiries of management, of appropriate individuals within the internal audit function (if the function exists), and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. (Ref: Para. A6–A13)
  - (b) Analytical procedures. (Ref: Para. A14–A16a7)
  - (c) Observation and inspection. (Ref: Para A18)
7. The auditor, in identifying and assessing the risks of material misstatement, shall take into account information obtained from the auditor's ~~client~~ acceptance or continuance ~~process of the client relationship or the audit engagement.~~ (Ref: Para. A18a)
8. If the engagement partner has performed other engagements for the entity, the engagement partner shall consider whether information obtained is relevant to identifying and assessing risks of material misstatement. (Ref: Para. A18b)
9. Where the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor shall ~~evaluatedetermine~~ whether such information remains relevant and reliable as audit evidence~~changes~~

~~have occurred since the previous audit that may affect its relevance to~~ for the current audit. (Ref: Para. A19–A20)

10. The engagement partner and other key engagement team members shall discuss the application of the applicable financial reporting framework in the context of the nature and circumstances of the entity and its environment, and the susceptibility of the entity's financial statements to material misstatement, ~~and the application of the applicable financial reporting framework to the entity's facts and circumstances.~~ The engagement partner shall determine which matters are to be communicated to engagement team members not involved in the discussion. (Ref: Para. A21–A24)

### The **Required** Understanding of the Entity and Its Environment and the Applicable Financial Reporting Framework (Ref: Para. A24a–A24b)

11. The auditor shall obtain an understanding of the entity and its environment and the applicable financial reporting framework, to provide an appropriate basis for the auditor to understand the classes of transactions, account balances and disclosures to be expected in the entity's financial statements. In doing so, the auditor shall obtain an understanding of:

(a) The entity and its environment, including:

- (i) The entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of information technology; (Ref: Para A3125–A4334)
- (ii) Relevant industry, regulatory and other external factors; and (Ref: Para. A38A43a–A43f)
- (iii) The relevant measures used, internally and externally, to assess the entity's financial performance. (Ref: Para. A44–A49)

(b) The applicable financial reporting framework, including: (Ref: Para. A49a–A49f)

- (i) How it applies in the context of the nature to the entity's facts and circumstances of the entity and its environment, taking into account events or conditions that may indicate risks of material misstatement and how such events or conditions are affected by, or subject to, the inherent risk factors; and
- (ii) The entity's accounting policies and any changes thereto, including the reasons for any changes to the entity's accounting policies.

~~to provide a sufficient and appropriate basis for the auditor to understand the classes of transactions, account balances and disclosures to be expected in the entity's financial statements. In obtaining this understanding, the auditor shall also consider whether and, if so, how the events or conditions are affected by, or subject to, the qualitative inherent risk factors.~~ (Ref: Para. A50)

- 11A. (Previously part of 11(c)) The auditor shall evaluate whether the entity's accounting policies, and any changes thereto, are appropriate in the context of the nature to its facts and circumstances of the entity and its environment, including the nature of its business, and consistent with the applicable financial reporting framework.

### The **Required** Understanding of the Entity's System of Internal Control

12. The auditor shall obtain an understanding of the entity's system of internal control relevant to financial reporting, including the entity's use of information technology, by understanding each of the components of internal control. For this purpose, the auditor shall ~~address the requirements perform the procedures~~ set out in paragraphs 14 ~~to, 15, and 17A through~~ 19A of this ISA. (Ref: Para. A50a–A67d6)
13. The auditor shall identify controls relevant to the audit, and shall evaluate the design of the controls and determine whether the controls have been implemented. For this purpose, the auditor shall address the requirements set out in paragraphs 20 to 21B. (Ref: Para. A74–A73a)

#### Components of the Entity's System of Internal Control

##### Control environment

14. The auditor shall obtain an understanding of the control environment relevant to financial reporting, including understanding the extent to which the entity: (Ref: Para. A77–A80d)
- (a) Demonstrates a commitment to integrity and ethical values;
  - (b) Demonstrates that those charged with governance are independent of management and exercise oversight of the entity's system of internal control;
  - (c) Establishes, with the oversight of those charged with governance, structures, reporting lines, and appropriate authorities and responsibilities, in pursuit of its objectives;
  - (d) Demonstrates a commitment to attract, develop, and retain competent individuals in alignment with its objectives; and
  - (e) Holds individuals accountable for their ~~internal control~~ responsibilities in the pursuit of ~~its the~~ objectives of the system of internal control.
- 14A. [*Previously paragraphs 14(a)-(b)*] Based on the auditor's understanding of the control environment, the auditor shall evaluate whether: (Ref: Para. A80e84–A827)
- (a) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior; and
  - (b) The strengths in those areas of the entity's control environment addressed in paragraphs 14(a) to (e) collectively provide an appropriate foundation for the other components of internal control, and whether those other components are not undermined by deficiencies in internal control with regard to the control environment component.
- 14B. ~~In performing the evaluation as required by paragraph 14A, if~~ the auditor has identified one or more deficiencies shall determine whether any deficiencies identified represent a significant deficiency in internal control in performing the evaluation as required by paragraph 14A, the auditor shall determine whether, individually or in combination, they constitute. ~~If the auditor identifies a significant deficiencies~~ es. y in internal control with regard to the control environment, if so, the auditor shall consider the implications for the audit, including in designing and implementing overall responses to address the assessed risks of material misstatement at the financial statement level as required by ISA 330.

The entity's risk assessment process

15. The auditor shall make inquiries about ~~the nature of whether~~ the entity's ~~has established a~~ risk assessment process, including its formality. ~~If such a process exists, t~~The auditor shall obtain an understanding of: (Ref: Para. A889–A89a94)
- (a) ~~The nature of the process, including w~~hether, and if so, how, the entity's process:
    - (i) Identifies business risks relevant to financial reporting objectives;
    - (ii) Assesses the significance of the risks, including the likelihood of their occurrence; and
    - (iii) Addresses those risks.
  - (b) The results of the entity's process~~thereof~~.
16. If the auditor identifies risks of material misstatement that management failed to identify, the auditor shall evaluate whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process. ~~If so there is such a risk,~~ the auditor shall obtain an understanding of why the entity's risk assessment process failed to identify ~~such risks~~<sup>it</sup>, and consider the implications for the auditor's evaluation required by paragraph 16A.
- ~~176A~~ Based on the auditor's understanding of ~~whether, and if so the extent to which,~~ the entity's ~~has a~~ risk assessment process in accordance with paragraph 15, the auditor shall: (Ref: Para. A89b–A89d)
- (a) Evaluate whether the nature of the entity's risk assessment process, or the absence thereof, is appropriate to the entity's circumstances considering the nature and size of the entity; and (Ref: Para. A92)
  - (b) If not, determine whether the lack of an appropriate risk assessment process represents one or more deficiencies ~~a significant deficiency~~ in internal control, and whether such deficiencies, individually or in combination, constitute significant deficiencies. If so, the auditor shall consider the implications for the audit, including in designing and implementing overall responses to address the assessed risks of material misstatement at the financial statement level as required by ISA 330. (Ref: Para. A93)

The entity's process to monitor the system of internal control (Ref: Para. A89e95–A89f96))

- 17A. (Previously paragraph 22) The auditor shall make inquiries about the nature ~~obtain an understanding~~ of the entity's process to monitor the system of internal control, including its formality. ~~relevant to financial reporting. In obtaining that understanding, t~~The auditor shall obtain an understanding of how the entity's process: (Ref: Para. A89g97–A89i104)
- (a) Monitors the ~~operating~~-effectiveness of controls; and
  - (b) Addresses the identification and remediation of deficiencies in internal control, including taking into account any deficiencies in the entity's risk assessment process.
- ~~17B~~ In addressing paragraph 17A, if the auditor identifies one or more deficiencies in internal control, the auditor shall determine whether, individually or in combination, they constitute significant deficiencies. If so, the auditor shall consider the implications for the audit, including in designing and implementing overall responses to address the assessed risks of material misstatement at the financial statement level as required by ISA 330.

- 17CB. (Previously paragraph 23) If the entity has an internal audit function,<sup>16</sup> the auditor shall obtain an understanding of the nature of the internal audit function's responsibilities, its organizational status, and the activities performed, or to be performed. (Ref: Para. A~~10289m~~–A~~10989g~~)
- 17DC. (Previously paragraph 24) The auditor shall obtain an understanding of the sources of the information used in the entity's process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose. (Ref: Para. A~~89r440~~)

#### The information system and communication

18. The auditor shall obtain an understanding of the information system relevant to financial reporting, including the related business processes, through understanding: (Ref: Para. A~~90a414~~–A~~90c415~~)
- (a) How information relating to significant classes of transactions, account balances and disclosures flows through the entity's information system, whether manually or using information technology, and whether obtained from within or outside of the general ledger and subsidiary ledgers. This understanding shall include how: (Ref: Para. A~~90d446~~–A~~92447~~)
- (i) Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, and reflected in ~~transferred to~~ the general ledger and reported in the financial statements; and
- (ii) Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial statements.
- (b) The ~~related~~ accounting records, specific accounts in the financial statements and other supporting records relating to the flows of information in paragraph 18(a); that are used to initiate, record, process and report significant classes of transactions, account balances and disclosures. This understanding shall include how:
- (i) ~~Incorrect information is corrected;~~
- (ii) ~~Information is transferred to the general ledger, where applicable; and~~
- (iii) ~~Other information used to develop significant disclosures is obtained from within or outside of the general and subsidiary ledgers.~~
- (c) The financial reporting process used to prepare the entity's financial statements from the ~~records~~information described in paragraph 18(b), including as it relates to disclosures and to accounting estimates ~~relating to~~that are included in significant classes of transactions, account balances and disclosures;
- (d) The entity's IT ~~environment~~infrastructure, including IT applications and the underlying IT infrastructure, relevant to (a) through (c) above. (Ref: Para. A~~92a418~~–A~~92c423~~)

18A. In obtaining the understanding required by paragraph 18, the auditor shall evaluate the design of the information system relevant to financial reporting, including those aspects in paragraph 18(a)–(d), and determine whether it has been placed into operation by the entity. (Ref: Para. A96a–A96d)

<sup>16</sup> ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, paragraph 14(a), defines the term "internal audit function" for purposes of the ISA.

19. The auditor shall obtain an understanding of how the entity communicates financial reporting roles and responsibilities and significant matters relevant to financial reporting, including: (Ref: Para. ~~A97-125–A125a~~)
- (a) Communications between management and those charged with governance; and
  - (b) External communications, such as those with regulatory authorities.

#### Control activities

- 19A. The auditor shall obtain an understanding of ~~how the entity addresses: (Ref: Para. A126) the control activities component by identifying the controls relevant to the audit in that component in accordance with the requirements of paragraphs 20 through 21A, and evaluating their design and determining whether they have been implemented in accordance with paragraph 21B. Ref: Para. A99–A99(i)~~
- ~~(a) Authorizations and approvals;~~
  - ~~(b) Physical controls, including those addressing security of assets; and physical counts or reconciliations of assets with accounting records;~~
  - ~~(c) Segregation of duties; and~~
  - ~~(d) General IT controls.~~

#### Controls relevant to the audit

20. The auditor shall identify controls relevant to the audit, being those: (Ref: Para. ~~A100-127–A129~~)
- (a) That ~~addressare relevant to~~ risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; (Ref: Para. A100a)
  - (b) That ~~address risks that~~ are ~~identified asrelevant to~~ a significant risk; (Ref: Para. A100b–A100e)
  - (c) Over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments; (Ref: Para. A100f–A100g)
  - (d) Controls of which the auditor plans to test the operating effectiveness in determining the nature, timing and extent of substantive testing; or (Ref: Para. A100h–A102a)
  - ~~(d)(e)~~ That, in the auditor's professional judgment, are otherwise appropriate to evaluate their design and determine whether they have been implemented to enable the auditor to:
    - (i) Identify and assess the risks of material misstatement at the assertion level; or
    - (ii) Design further audit procedures responsive to assessed risks; ~~or~~
  - ~~(e) That the auditor plans to test the operating effectiveness of.~~

*(Previously in paragraph 12)* Not all controls that are relevant to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment as to whether a control, individually or in combination with other controls, is identified as being relevant to the audit.

21. Based on the ~~auditor's~~ understanding obtained in accordance with paragraph 18(d), and in order to enable the of the risks related to IT, the auditor shall identification of general IT controls relevant to the audit in accordance with paragraph 21A. In doing so, the auditor shall identify the risks arising from IT. take into account whether and, if so, the extent to which the general IT controls are related to the following types of automated controls: (Ref: Para. A106a–A106c)

21A. The auditor shall identify general IT controls relevant to the audit. In doing so, the auditor shall take into account whether and, if so, the extent to which the general IT controls are related to: (Ref: Para. A108)

- (a) Automated controls that~~That~~ management is relying on and that the auditor has determined to be relevant to the audit;
- (b) ~~That management is relying on that e~~nsuring the integrity of information stored and processed in the information system that relates to significant classes of transactions, account balances or disclosures;
- (c) ~~Related to s~~System-generated reports on which the auditor intends to rely on without directly testing the inputs and outputs of such reports; or
- (d) ~~Related to r~~Risks for which substantive procedures alone do not provide ~~are not sufficient to obtain~~ sufficient appropriate audit evidence.

21BA. ~~(Previously paragraph 13).~~ For each control identified as relevant to the audit in accordance with paragraphs 20 and 21, the auditor shall: (Ref: Para. A~~109a-130~~109a-134)

- (a) Evaluate the design of the control, through directly or indirectly relating each ~~Relate each identified~~ control relevant to the audit to potential risk(s) of material misstatement ~~the audit to what could go wrong~~ at the assertion level; and
- (b) ~~Evaluate the design of the controls, and d~~determine whether the control has been implemented by performing procedures in addition to inquiry of the entity's personnel.

[~~Previous paragraphs 22, 23 and 24 are MOVED TO paragraphs 17A, 17B and 17C~~]

### **Identifying and Assessing the Risks of Material Misstatement**

25. The auditor shall identify and assess the risks of material misstatement at the financial statement and assertion levels in accordance with paragraphs 25A through 30B to provide an appropriate basis for the auditor's overall responses and designing and performing further audit procedures. In assessing the risks of material misstatement at the assertion level, the auditor shall separately assess inherent risk and control risk. (Ref: Para. A121a–A121e)

25A. When obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, the auditor shall identify potential risks of material misstatement. (Ref: Para. A121f–A121i)

25B. In relation to the identified potential risks of material misstatement the auditor shall: (Ref: Para. A121j–A121m)

- (a) ~~(Previously paragraph 26(d))~~ Consider the ~~nature of, and reasons for, the~~ likelihood and magnitude of potential misstatements, including the possibility of multiple misstatements, and whether the potential misstatement(s) could result in a material misstatement. ~~(Ref: Para. A154–A155)~~
- (b) ~~(Previously paragraph 25) Based on the auditor's understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, the auditor shall i~~ identify the risks of material misstatement at; ~~and shall assess the risks of material misstatement at:~~ (Ref: Para. A~~135~~137)

- i. The financial statement level, by ~~determining~~evaluating whether the identified risks relate more pervasively to the financial statements as a whole and potentially affect many assertions; and (Ref: Para. A1~~2238~~–A1~~2538d~~)
- ii. The assertion level for significant classes of transactions, account balances, and disclosures, ~~by separately assessing inherent risk and control risk~~ (Ref: Para. A139–A145)

~~to provide a sufficient and appropriate basis for designing and performing further audit procedures.~~

- (c) (Previously paragraph 26(a)) Identify significant classes of transactions, account balances and disclosures, and their relevant assertions. (Ref: Para. A1~~25a146~~–A153)

26. For the identified risks of material misstatement at the assertion level, the auditor shall assess inherent risk by:

- (a) Assessing the likelihood and magnitude of material misstatement. In doing so, the auditor shall take into account how, and the degree to which, identified events and conditions relating to significant classes of transactions, account balances and disclosures are subject to, or affected by, the inherent risk factors. (Ref: Para. A125b–A126)
- (b) Evaluating the extent to which the identified risks of material misstatement at the financial statement level affect inherent risk for risks of material misstatement at the assertion level. (Ref. Para. A126a–A126c)

#### *Inherent Risk*

~~26. In order to identify and assess the risks of material misstatement at the assertion level and assess inherent risk as required by paragraph 25(b), the auditor shall: (Ref. Para A145a)~~

~~(c) Relate the identified risks to what could go wrong at the assertion level.~~

27. Based on the auditor's assessment of inherent risk, the auditor shall determine, taking into account the assessment of inherent risk at the assertion level, whether any of the identified risks of material misstatement identified are, in the auditor's judgment, a significant risks. (Ref: Para. A1~~4056~~–A144a164)

~~27A. In addressing the requirements in paragraphs 26 and 27, the auditor shall take into account how the susceptibility to misstatement is subject to, or affected by, the qualitative inherent risk factors.~~

29. [MOVED to paragraph 20 and 21B]

#### *Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence*

29A. (In December 2017, this was paragraph 30) The auditor shall ~~determine~~consider whether there are any risks of material misstatement at the assertion level for which it is not possible or practicable to obtain sufficient appropriate audit evidence ~~only~~ from substantive procedures alone. (Ref: Para. A1~~4866~~–A15068)

#### *Control Risk*

30. (In December 2017, this was paragraph 29A) ~~In order to identify and assess the risks of material misstatement at the assertion level, and in assessing control risk at the assertion level as required~~

~~by paragraph 25(b) above, the auditor shall considering the extent to which the controls that the auditor intends to test the operating effectiveness of address the auditor's assessment of inherent risk. (Ref: Para. A162–A165) The auditor shall assess control risk at the assertion level as follows: (Ref: Para. A150a–A150d)~~

- ~~(a) When the auditor does not plan to test the operating effectiveness of controls in designing further audit procedures to be performed to address a risk of material misstatement at the assertion level, the auditor shall assess control risk at the maximum; or~~
- ~~(b) When the auditor plans to test the operating effectiveness of controls in designing further audit procedures to be performed to address a risk of material misstatement at the assertion level, the auditor shall assess control risk at less than maximum. The auditor shall take into account the extent to which the design, implementation and expected operating effectiveness addresses the assessed inherent risk.~~

*Classes of Transactions, Account Balances and Disclosures that are Not Significant, but are Material*

30A. The auditor shall: (Ref: Para. A150e–A150h)

- (a) Identify the classes of transactions, account balances and disclosures that are quantitatively or qualitatively material, but that, based on performing the procedures in paragraphs 25 to 29A, have not been identified as significant in accordance with paragraph 26(b); and
- (b) Reassess whether there are any relevant assertions for these classes of transactions, account balances and disclosures (i.e., whether there are any related risks of material misstatement at the assertion level).

*Revision of Risk Assessment*

31. The auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where~~When~~ the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the identification and assessment of the risks of material misstatement, the auditor shall revise the assessment and modify the further planned audit procedures accordingly. (Ref: Para. A~~1514~~69)

**Documentation**

32 The auditor shall include in the audit documentation:<sup>17</sup> (Ref: Para. A152–A155)

- (a) The discussion among the engagement team, where required in accordance with paragraph 10, and the significant decisions reached;
- (b) Key aspects of the auditor's understanding obtained regarding the entity and its environment specified in paragraph 11 and of each of the internal control components specified in paragraphs 14, 15, 17A through 19A; the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed;
- (c) The controls relevant to the audit in accordance with the requirements in paragraphs 20 and 21. (Ref: Para. A170–A173)

<sup>17</sup> ISA 230, *Audit Documentation*, paragraphs 8–11, and A6

- (d) ~~(e)~~ The identified and assessed risks of material misstatement at the financial statement level and at the assertion level as required by paragraph 24, including the related ~~and the~~ significant judgments, ~~in making the assessments; and~~
- ~~(d) The risks identified, and related controls, as a result of the requirements in paragraphs 24A–24B. (Ref: Para. A170–A173).~~