



Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: New York, United States of America
Meeting Date: September 11–12, 2018

Agenda Item J

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

Objectives of Agenda Item

1. The objectives of this agenda item are to:
 - (a) Provide a report back on comments of the CAG Representatives on this project as discussed at the March 2018 meeting.
 - (b) Receive a presentation on the key revisions to the standard as approved by the IAASB, including the flowcharts.

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

2. Since the March 2018 IAASB CAG meeting, Exposure Draft of International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement* (ED–315) was approved by the IAASB in June 2018 for public exposure (see Agenda Item J.1: ED–315, which also includes the conforming amendments to other ISAs as well as the Explanatory Memorandum)
3. In addition to ED–315, the IAASB also published:
 - ED–315 supplement: *Proposed Conforming Amendments to ISA 540 (Revised)*¹ and *Paragraph A42 of ISA 200*.² The supplement was approved by the IAASB during a teleconference on July 17th 2018.
 - ISA 315 (Revised) – Overall risk assessment flowchart.
 - ISA 315 (Revised) – Obtaining an understanding of the entity’s system of internal control flowchart.
 - ISA 315 (Revised) – The auditor’s understanding of the IT environment and the identification of general IT controls relevant to the audit flowchart.

ED–315, including the supplement and flowcharts, can be viewed on the [\[IAASB website\]](#).

¹ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

² ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

4. **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.

Feedback - What Did We Hear Last Time We Met?

5. Extracts from the draft minutes of the March 2018 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. References have been updated in accordance with **ED-315 – Agenda Item J.1**

Representatives' Comments	Task Force/IAASB Response
GENERAL	
<p>Mr. Yurdakul noted that the standard had been made more complex, adding that some of the language would also be difficult to translate. Mr. Yurdakul also highlighted the complexity of the revised paragraphs relating to understanding the entity's system of internal control, encouraging the ISA 315 Task Force to further consider enhancement of the application material to assist with implementation.</p> <p>Representatives also emphasized the importance of the risk assessment process, and highlighted the importance of professional judgment and professional skepticism in this process, although Mr. Yurdakul noted that more is needed in ISA 315 (Revised) related to professional skepticism.</p>	<p>Point noted.</p> <p>To address complexity, the IAASB agreed to include an overall narrative in the introductory paragraphs to explain the flow and iterative nature of the standard – see ED-315 Paragraphs 4-12.</p> <p>The IAASB also developed of three flowcharts that provide visual representations showing how the iterative nature of the standard and how the various sections interact, The flowcharts were published as part of ED-315 – see [link].</p> <p>In relation to professional skepticism, this concept was further emphasized in the introductory paragraphs by highlighting its importance during the risk assessment process – see ED315 – Paragraph 2.</p> <p>ED-315 contains several key provisions that are designed to enhance the auditor's exercise of professional skepticism – these provisions were summarized in Appendix 1 of the [explanatory memorandum] of ED-315. The IAASB considered whether more was needed on professional skepticism, but on balance, it was agreed that the enhancements that had been made were appropriate to drive auditor behavior in relation to professional skepticism.</p>
<p>Mr. Iinuma expressed concern about how some of the new definitions added to the complexity of the risk assessment process. He added that it was difficult to understand the flow of how an auditor would perform the risk assessment process, in</p>	<p>Point noted.</p> <p>Refer to the IAASB response above.</p>

Representatives' Comments	Task Force/IAASB Response
particular that paragraphs 25 and 26 are not clear, highlighting that the interaction of the definitions may also add to the difficult in practically implementing the revised requirements.	
Mr. Rockwell encouraged the ISA 315 Task Force to further consider developing a flowchart (or graphic) to assist with understanding the flow of the revised requirements and therefore assist with effective implementation of the standard.	Point accepted. The IAASB developed three flowcharts (that accompany the explanatory memorandum) that provide visual representations of how the standard should be applied – see [link] .
Mr. Hansen acknowledged the enhancements made in relation to data analytics, but noted that no requirement had been added for the establishment of the auditor's expectations when performing analytical procedures as risk assessment procedures. He noted that this may cause confusion as some had the view that expectations were required, the same as analytical procedures performed when gathering audit evidence (i.e., to comply with ISA 520). ³ He encouraged the ISA 315 Task Force to further consider whether expectations should be required.	Point noted Ms. Campbell explained that analytical procedures performed as part of the risk assessment process was information gathering and therefore different to the gathering of audit evidence form analytical procedures. She added that expectations could be used in the risk assessment stage but that this was not a requirement, and noted that this was further explained in the application material (see ED-315 Paragraph A34) to clarify this point. Ms. Campbell explained that matters relating to the data used in automated tools would further be considered by the Data Analytics Working Group (DAWG) (possibly as part of the Audit Evidence project) as this was broader than risk assessment procedures.
In relation to the new introductory paragraphs introduced to help make the link to other ISAs of some key concepts used in ISA 315 (Revised), Mr. van der Ende noted that the description of the 'spectrum of risk' was confusing as it may suggest that risk is a 'point estimate.'	Point noted. The IAASB has revised its description of the spectrum of inherent risk in the introductory paragraphs: ' <i>The degree to which inherent risk varies, is referred to in this ISA as the spectrum of inherent risk</i> ' – see ED-315 Paragraph 5 .
DEFINITIONS	
Mr. van der Ende cautioned about using the term 'highest' risk in the definition of significant risk as that may suggest that it is only the highest risk that	Point accepted. Ms. Campbell acknowledged that this may be an unintended consequence of the wording used, and agreed that the ISA 315 Task Force would further

³ ISA 520, *Analytical Procedures*

Representatives' Comments	Task Force/IAASB Response
is a significant risk (i.e., this may be interpreted to mean that only one significant risk is identified).	<p>consider how this could be better articulated so that it did not suggest only one significant risk.</p> <p>After further deliberation in which various alternates were considered, the IAASB agreed to change the term to '<i>close to the upper end</i>' of the spectrum of inherent risk – see ED-315 Paragraph 16(k).</p>
Mr. Rockwell queried whether the introduction of the term "reasonably possible" was intended to mean something different from 'remote possibility,' and if so, what the difference may be.	<p>Ms. Campbell explained that it was intended to mean the same thing and noted that the definition had been revised to make that clear, but added that the ISA 315 Task Force would reconsider so that this was clear.</p> <p>After further deliberation by the IAASB, it was agreed that no further changes were required, however, a specific question will be directed to stakeholders on this matter in the [explanatory memorandum] of ED-315 – see Section 4, Question 6(d)</p>
Mr. Thompson queried whether there would be more relevant assertions than what would result from applying the extant requirements, and if this was expected, suggested that this should be communicated.	<p>Ms. Campbell agreed that the ISA 315 Task Force would further consider this.</p> <p>In its deliberations, the IAASB agreed that the enhancements to the risk assessment process, and in particular the identification of relevant assertions, would contribute to the identification of risks of material misstatement with more granularity and rigor. Accordingly, the extent of the identified relevant assertions, compared to the extant requirements, was not identified as a key focus area. Nonetheless, even if more relevant assertions were to be identified under the revised requirements, the IAASB concluded that this will result in a better risk assessment and ultimately contribute to audit quality.</p> <p>In addition, it was agreed to include a specific question on the concept of 'relevant assertions' to stakeholders – see Section 4, Question 6(d) of the [explanatory memorandum] in ED-315.</p>
Mr. Rockwell added that further consideration should be given to the consequences of the	Point noted.

Representatives' Comments	Task Force/IAASB Response
<p>changes being made as the project progressed, in particular whether there may be other unintended consequences.</p>	<p>The IAASB's development of the proposals went through various iterations, where further consequences of the proposals would have been considered.</p> <p>The IAASB will also carefully consider any unintended consequences that may be brought to its attention through the responses to ED-315.</p>
<p>Mr. Ruthman cautioned against the use of certain terms such as 'significant' and 'material' as a descriptor as these may be used interchangeably by some in the same circumstances.</p>	<p>Point noted.</p> <p>Ms. Campbell noted that it was likely that this would only be an issue in paragraph 18 of ISA 330⁴ where the term 'material' is used, and that it was specifically used in that paragraph as it was material balances that were being targeted.</p> <p>The IAASB has also proposed a new 'stand-back' requirement (ED-315 Paragraph 52),⁵ which is intended to drive an evaluation of the completeness of the significant classes of transactions, account balances and disclosures identified by the auditor. The stand-back is intended to focus on <i>material</i> classes of transactions, account balances or disclosures (that have <i>not been determined to be significant</i> i.e., the auditor has not identified any risks of material misstatement that are reasonably possible and therefore for which there are no relevant assertions). The description of 'material' has been expanded to be 'quantitatively or qualitatively material' with supporting application material to describe its meaning in this context.</p> <p>The IAASB has proposed revisions to paragraph 18 of ISA 330 to apply to classes of transactions, account balances or disclosures that are 'quantitatively or qualitatively material' to align with the scope of the proposed stand-back in ED-315 and has also updated the related application material to explain the interaction of the requirement with the new concept of</p>

⁴ ISA 330, *The Auditor's Responses to Assessed Risks*

⁵ Proposed paragraph 52 of ED-315 requires the auditor to reconsider whether all significant classes of transactions, account balances and disclosures have been identified once the initial risk identification and assessment has been completed.

Representatives' Comments	Task Force/IAASB Response
	<p>significant classes of transactions, account balances and disclosures.</p> <p>The IAASB also agreed to include a specific question on the stand back requirement and its interaction with paragraph 18 of ISA 330. See Section 4, Question 8 of the [explanatory memorandum].</p>
<p>Mr. Rothwell noted that fraud was now incorporated in the inherent risk factor relating to the susceptibility to management bias, highlighting that fraud didn't always arise from management. He suggested that further consideration should be given to how fraud is addressed in ISA 315 (Revised), in particular as the susceptibility to fraud had been eliminated as a separate inherent risk factor. Mr. Baumann noted that the PCAOB had embedded considerations around fraud throughout its risk assessment standard, so that the auditor's considerations about fraud are not undertaken in isolation.</p>	<p>Point noted.</p> <p>Ms. Campbell acknowledged that in relation to the inherent risk factors, an explicit reference to fraud had been removed, but emphasized that there was ISA 240 focused auditors on considerations about fraud. However, she added that the ISA 315 Task Force would further consider how the link back to ISA 240 could be enhanced in ISA 315 (Revised), and would further look at how the PCAOB had embedded fraud throughout the risk assessment process.</p> <p>After further deliberation by the IAASB, it was agreed to re-introduce fraud as an inherent risk factor, i.e. '<i>the susceptibility to misstatement due to management bias or fraud</i>' – see ED-315 Paragraph 16(f).</p> <p>In addition, the IAASB has agreed that there are sufficient references to fraud in the standard, as also discussed in paragraph 28 (and summarized in appendix 1) of the [explanatory memorandum].</p>
<p>Representatives queried whether there was a need for new definitions:</p> <ul style="list-style-type: none"> • Mr. Ruthman queried whether there is a need for a definition of 'controls relevant to the audit.' 	<p>Points not accepted</p> <p>Ms. Campbell explained that the ISA 315 Task Force had considered a definition, but had agreed that it would be difficult to define because of the complexity in identifying controls that are relevant to the audit, and therefore had the view that it was more appropriate to explain what was meant by controls relevant to the audit through the requirements and application material – see ED-315 Paragraphs 39 and A166-A193 of the standard.</p>

Representatives' Comments	Task Force/IAASB Response
<ul style="list-style-type: none"> Mr. Bini queried whether a definition was needed for 'business model.' 	<p>Ms. Campbell explained that it would be difficult to define the concept, but added that the ISA 315 Task Force had added application material to explain what was involved in obtaining an understanding of the entity's business model, particularly in light of the importance of the entity's business model in identifying and assessing risks of material misstatement – see ED-315 Paragraphs A52-A58 of the standard.</p>
<p>In response to Ms. Campbell's comments regarding a definition of controls relevant to the audit, Mr. Ruthman noted that the material in paragraph 20 (relating to the list of controls relevant to the audit) may be helpful earlier in the standard.⁶</p>	<p>Point noted.</p> <p>After further deliberation, the IAASB agreed that the material relating to controls relevant to the audit (ED-315 Paragraph 39) is best suited to follow the control activities component section of ED-315. Further, earlier in the standard, in the overarching requirement to obtain an understanding of the system of internal control, paragraph 26 of ED-315 requires the auditor to obtain this understanding in accordance with the requirements in paragraph 39 to 42.</p>
SCALABILITY	
<p>Ms. Robert encouraged the ISA 315 Task Force to further consider how the standard could better reflect how the requirements could be applied to non-complex entities, and scaled up as the entity becomes more complex.</p>	<p>Ms. Campbell highlighted that scalability was an area that the ISA 315 Task Force would continue to focus on as the exposure draft was finalized.</p> <p>The IAASB agreed to include in the application material considerations for audits of entities that are both smaller and less complex, which are those audits that would typically require simpler risk assessment procedures. Some of these considerations are contrasted with considerations for audits of larger, complex entities (e.g., in relation to the understanding of an entity's use of IT). This approach is intended to demonstrate scalability in both directions, in relation to the nature, timing and extent of the auditor's risk assessment procedures</p> <p>It was further recognized that the considerations for audits of smaller and less complex entities may also</p>

⁶ In the final renumbered version of ED-315, paragraph 20 is now paragraph 39

Representatives' Comments	Task Force/IAASB Response
	<p>be relevant to audits of larger entities that have simple business models or financial reporting processes and where the auditor's risk assessment may also be simpler. The introductory paragraphs therefore note that some of the considerations for entities that are both smaller and less complex may be applicable in audits of larger and less complex entities – see ED-315 Paragraph 13.</p> <p>The IAASB also agreed to:</p> <ul style="list-style-type: none"> • Include a table in the explanatory memorandum that draws attention to those paragraphs in the standard that demonstrate scalability – see Appendix 1 of the [explanatory memorandum] included in ED-315. • Obtain stakeholder views on the scalability of the standard – see Section 4, Question 2 of the [explanatory memorandum] included in ED-315.
PIOB REMARKS	
<p>Ms. Petterson encouraged the ISA 315 Task Force to further consider reinstating the susceptibility to fraud as an inherent risk factor, to continue to encourage the auditor to consider fraud throughout the risk assessment process and not as an isolated work effort.</p>	<p>Ms. Campbell reminded Representatives that this had been removed as an inherent risk factor because fraud impacts both inherent and control risk. She further explained that the inherent risk factors related to inherent risk, and therefore the ISA 315 Task Force had considered the appropriateness of the susceptibility of fraud as an inherent risk factor and eliminated it as a separate inherent risk factor. However, she added that further consideration would be given to how fraud could be further emphasized throughout the risk assessment process so as not to lose the focus on fraud in ISA 315 (Revised), but being mindful of not repeating matters set out in ISA 240. She also added that consideration would be given to how a flowchart could also better make the link to the other standards (such as ISA 240).</p> <p>After further deliberation by the IAASB, it was agreed to re-introduce fraud as an inherent risk factor, i.e. <i>'the susceptibility to misstatement due to</i></p>

Representatives' Comments	Task Force/IAASB Response
	<i>management bias or fraud</i> – see ED-315 Paragraph 16(f) of the standard.
Ms. Petterson also acknowledged the ISA 315 Task Force's efforts regarding technology in the revisions, but encouraged that further consideration be given to updating concepts related to more contemporary terminology (for example continuous control monitoring).	Point noted The IAASB has considered whether terminology in ED-315 would remain relevant taking into account the rapid or evolving changes in technology (i.e., did not want to outdate the standards current developments in technology evolve). For example, it was agreed to move the terms ' <i>data warehouses</i> ' and ' <i>report writers</i> ,' as included in the definition of the <i>IT environment</i> , to the application material – see ED-315 Paragraph A7 .

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
- 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

	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 2016 December 2016 March 2017 September 2017 October 2017 December 2017 March 2018
Discussion and approval of ED-315		May 2018 teleconference June 2018 July 2018 teleconference

IAASB CAG Discussions: Detailed References

Information gathering	<p><u>March 2016</u></p> <p>See IAASB CAG meeting material (Agenda Item C) and meeting minutes (Agenda Item A):</p> <p>http://www.iaasb.org/cag/meetings/paris-france</p>
Project Proposal	<p><u>September 2016</u></p> <p>See IAASB CAG meeting material (Agenda Item D) and meeting minutes (Agenda Item C)</p> <p>http://www.iaasb.org/cag/meetings/new-york-usa</p>
Development of ED-315	<p><u>September 2016</u></p> <p>See IAASB CAG meeting material (Agenda Item D) and meeting minutes (Agenda Item C)</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) and meeting minutes (Agenda Item C)</p> <p>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)</p> <p>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)</p> <p>http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny</p> <p><u>June 2018</u></p> <p>Voluntary IAASB CAG teleconference – during this meeting the Task Force Chair presented key developments since March 2018, as presented in the ISA 315 (Revised) IAASB June 2018 materials.</p> <p>http://www.iaasb.org/meetings/new-york-usa-19</p>