ISA 315 (Revised) – Responding to Comments to the Exposure Draft

• CAG Meeting
• March 5th, 2019

Fiona Campbell
ISA 315 (Revised), Deputy Chair of the IAASB and Chair of the ISA 315 Task Force
ED 315 — Understanding the Entity’s System of Internal Control

**Definitions**

<table>
<thead>
<tr>
<th>New</th>
<th>Revised</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Application controls</td>
<td>1. Controls</td>
</tr>
<tr>
<td>2. General IT controls</td>
<td>2. Access controls (glossary)</td>
</tr>
<tr>
<td>3. IT environment</td>
<td></td>
</tr>
</tbody>
</table>

**Components of Internal Control**

1. Control environment
2. The entity’s risk assessment process
3. The entity’s process to monitor the system of internal control
4. The information system and communication
5. Control activities

- Maintained the 5 components of internal control
  - Enhanced as necessary to align with COSO
- Controls definition
  - Recognizes ‘less formalized’ policies and procedures (scalability)
**Definitions**

<table>
<thead>
<tr>
<th>New</th>
<th>Revised</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Inherent risk factors</td>
<td>1. Assertions</td>
</tr>
<tr>
<td>2. Relevant assertion</td>
<td>2. Significant risk</td>
</tr>
<tr>
<td>3. Significant classes of transactions,</td>
<td></td>
</tr>
<tr>
<td>account balances or disclosures</td>
<td></td>
</tr>
</tbody>
</table>

**Inherent risk factors include:**

1. Complexity
2. Subjectivity
3. Uncertainty
4. Change
5. Susceptibility to misstatement due to management bias or fraud

**Key change in assessing risk of material misstatement**

*Separate* assessment of inherent risk and control risk

**Concept of ‘spectrum of inherent risk’**

The degree to which inherent risk varies, is referred to as the ‘spectrum of inherent risk’ – consider likelihood and magnitude of material misstatement to determine where on the spectrum the risk lies.
## Responses to ED-315

### Respondents (by type)

<table>
<thead>
<tr>
<th>Type</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>72</td>
</tr>
<tr>
<td>Member Bodies and Other Professional Organizations</td>
<td>27</td>
</tr>
<tr>
<td>National Auditing Standard Setters</td>
<td>11</td>
</tr>
<tr>
<td>Accounting Firms</td>
<td>11</td>
</tr>
<tr>
<td>Regulators and Oversight Authorities</td>
<td>9</td>
</tr>
<tr>
<td>Individuals and Others</td>
<td>7</td>
</tr>
<tr>
<td>Public Sector Organizations</td>
<td>6</td>
</tr>
<tr>
<td>Academics</td>
<td>1</td>
</tr>
</tbody>
</table>

The pie chart illustrates the distribution of responses by type, with the following percentages:

- **38%** for Member Bodies and Other Professional Organizations
- **15%** for National Auditing Standard Setters
- **15%** for Accounting Firms
- **10%** for Regulators and Oversight Authorities
- **8%** for Individuals and Others
- **1%** for Public Sector Organizations
- **1%** for Academics

Respondents (by type)
Overarching concerns:

- Broad concerns about the **complexity** and **length** of the proposed standard; as well as **scalability/proportionality**. Concerns included:
  - Standard too prescriptive/detailed and over-engineered for SMEs (flow not clear)
  - Iterative nature of the standard not clear, some areas noted as being circular
  - Introduction of many new definitions and concepts; more clarity needed

**BUT, support for individual aspects, such as:**

- Flowcharts
- Introductory paragraphs
- Separate assessment of IR and CR
- Automated tools and techniques
- Inherent risk factors (except fraud)
- Spectrum of inherent risk
Responses to ED–315

Mixed views:

• Addition of obtaining ‘sufficient appropriate audit evidence’ as the basis for risk identification and assessment
• Various aspects of ‘controls relevant to the audit’ (e.g., specifying which controls are relevant to the audit; those that are designated in the auditor’s judgment)
• ‘Susceptibility to fraud’ as an inherent risk factor
• Enhancements made regarding financial statement level risks
• In definition of relevant assertion – where there is a ‘reasonable possibility of a misstatement’ and how it relates to a possibility that is ‘more than remote’ – view that these are not the same
• Definition of significant risk
• New stand-back and ISA 330 para 18
Task Force Action – Overall Response

• Calls from respondents to:
  – Maintain ‘principles-based’ standards
  – Use simpler language and reduce overall complexity within the requirements
  – Maintain robustness of requirements
  – Enhance consistency of application

• Recognition of complexity and scalability/proportionality concerns → Focus area for IAASB

• IAASB to discuss ‘overall’ response to broad concerns at March 2019 meeting
  – Alternatives presented for discussion relating to “understanding the system of internal control”
    • Same outcome
  – Option 1: address concerns and issues by providing further clarity in requirements
  – Option 2: largely based on Option 1 requirements, but presented differently (e.g., some detail now in definitions) therefore is shorter
Task Force Action – Changes to the Application Material

• Task Force to consider application material once approach to requirements agreed on

• Proposals to:
  – Address long, complex paragraphs
  – **Simplify language** where possible
  – Use **bullet lists** where possible – easier to read
  – **Consistency** across sections where possible
  – Should the guidance be maintained in application material or elsewhere?
  – Distinguishing **separate “scalability” paragraphs**
  – **Distinguish examples** e.g., in a box or indented
In relation to the **ISA 315 Table of Drafting (Agenda Item B.2)**, consider the 2 different alternatives in presenting the requirements of the standard:

<table>
<thead>
<tr>
<th>Alternative 1:</th>
<th>Alternative 2:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Column 3 – Option 1</td>
<td>Column 4 – Option 2</td>
</tr>
</tbody>
</table>

Representatives are asked whether the broad approach to apply an ‘overall response’ (column 4 – option 2) to draft the requirements could be an effective way to address the overarching comments from respondents relating to complexity and scalability / proportionality? If not, why not?
Task Force Action – Revisions to ED-315 (Column 3)

Understanding the System of Internal Control

• Overarching requirement to obtain an understanding of the system of internal control
  – Overall purpose added
• Terminology changes
  – Controls relevant to the audit
  – Relevant to financial reporting
  – Formality / formalized
• Individual components restructured
  – Consistency between components
  – Prominence to purpose of understanding
  – Clarity of work
• Stronger distinction between information system and control activities
• Clarifications re D&I
Question 2

Consider the proposed revisions to ‘Understanding of the Entity’s System of Internal Control’ – Agenda Item B.2 (Column 3). Representatives are asked for their views on the proposed changes.
Task Force Action – Revisions to ED–315

Identifying and Assessing the Risks of Material Misstatement (Individual Issues)

- Addition of obtaining ‘sufficient appropriate audit evidence’ as the basis for risk identification and assessment — proposal to change to provide a basis for…
- ‘Susceptibility to fraud’ as an inherent risk factor – Task Force still considering how to address
- Enhancements made regarding financial statement level risks – Task Force still considering how to address
- In definition of relevant assertion – where there is a ‘reasonable possibility of a misstatement’ and how it relates to a possibility that is ‘more than remote’ – view that these are not the same
  - Proposal to remove ‘more than remote’
  - Further consideration about how to explain the ‘threshold’
- Definition of significant risk – proposal to change to ‘AND’ – will scope out those with low likelihood of occurrence
- Whether to keep new ‘stand-back’ or ISA 330 para. 18, or keep both, or not have either
  - On balance Task Force proposes to keep both
ISA 315 (Revised) — The Way Forward

IAASB approved ED–315

June 2018

Nov. 2, 2018

Comments closed

Nov. 2018–Sept. 2019
Development of final standard

[Planned effective date of standard] – Audits of financial statements for periods beginning on or after 18 to 24 months after approval

Sept. 2019

Targeted approval of final standard

18-24 months

Further consideration by IAASB about implementation guidance

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• Are there any other matters that the Task Force should consider as it progresses the changes to ED–315?