

IFAC Small and Medium Practices Committee Response to the IAASB's Exposure Draft, Proposed International Standard on Auditing 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement and Proposed Consequential and Conforming Amendments to Other ISAs*

INTRODUCTION

The SMP Committee (SMPC) is pleased to respond to the IAASB (the Board) Exposure Draft (the ED), Proposed International Standard on Auditing 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement*. The SMPC is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small- and medium-sized entities (SMEs). The constituents of the SMPC are small- and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members and Technical Advisers serving the SMPC are drawn from IFAC member bodies representing 20 countries from all regions of the world.

GENERAL COMMENTS

ISA 315 (Revised) is arguably the single most important ISA as it forms the foundation for an audit. It is therefore critical that it can be operationalized for audits of all different sizes and complexities. The background in the Explanatory Memorandum states that auditors of SMEs have previously raised specific challenges from a scalability perspective in effectively and efficiently applying the extant ISA 315. We therefore support the IAASB revising ISA 315 and commend the Board on the considerable amount of work that has been undertaken in developing the proposals and modernizing the standard. Nevertheless, the SMPC strongly urges the IAASB to take the necessary time to ensure the final version of this standard is fit for purpose for all segments of the audit market worldwide. Any flaws will be repeated and magnified as other ISAs re-iterate the requirements of this ISA and the issues being addressed are not straightforward. Every effort must be made to ensure that existing problems are resolved and are neither perpetuated nor exacerbated in the new standard.

The SMPC valued the opportunity to contribute to this project as it has progressed. Overall, we remain very concerned about the length and complexity of the standard, as well as the lack of a clear steer in respect to several key aspects and the combined impact in terms of this standard's application in practice.

We have serious concerns that without considerable amendment, the ED would lead to inefficiencies (detrimental in terms of the cost/ benefit considerations of entities subject to audit) and inconsistent application (detrimental to the achievement of high-quality audits). Given this, our concern is that the ED would not result in the IAASB achieving its public interest goals, as it could lead to further reductions in the audit market, when governments perceive a need to relieve SMEs of the (increasing) burden of audit by raising audit thresholds.

ISAs are the gold standard, but the word 'audit' is not subject to copyright. We do not wish to see auditing standards for SMEs being developed by national standard setters, as it would lead to divergent regulation and a lack of harmonization. If SMPs have difficulties in applying ISA standards and governments raise audit thresholds as a result of that, some will argue that it is of no consequence because SMEs do not need an audit, or should avail themselves of some lesser service. We believe that this line of thinking is pernicious

and wrong in principle. We strongly believe that IAASB should continue to set standards for audits of all sizes. This may be the last chance it has to prove that it is able, and willing to do so, and we urge IAASB to do whatever it takes to make this ISA workable for all audits; otherwise it may accelerate the trend for SMPs to voluntarily exit the audit market, eroding competition and leave SMEs with little choice but to use larger firms, which is also detrimental to the public interest. Audits have a significant role in both trust and transparency that society is demanding and provides valuable information on the risks and sustainability of organizations, including SMEs.

The revision introduces new, closely interrelated and as yet untested terms, concepts and definitions including inherent risk factors, relevant assertions, a spectrum of risk, and a great deal of granular material on IT issues. Terminology has been inappropriately imported from the PCAOB's standards and many other aspects are over-engineered for the SME environment. Cumulatively, this may trigger, if not mitigated, a rejection of the standard in terms of its suitability for SME audits and further calls for different standards for SME audits compared to listed/ PIE audits. We understand that SMPs are not alone in concerns regarding unnecessary complexity and that larger firms also have similar concerns.

The proposals as they stand are methodologically complex. This will foster a tick box mentality to risk assessment for less complex entities, potentially resulting in the auditor being "unable to see the wood for the trees" and diverting resources from achieving the desired audit quality. We therefore urge the IAASB to find a way to reduce this complexity before finalizing the standard.

In summary, the key issues we have identified are as follows:

- Concern that the length, complexity and over-engineering of some of the proposals will mean that risk assessments will involve increasingly detailed work including documentation, which may not necessarily improve audit quality, but which would make audits inefficient from a cost/ benefit perspective for smaller and less complex entities.
- A failure to make the audit approach sufficiently scalable, including new features compared to extant ISA 315 (Revised). The "drill down" in risk identification below the assertion level, whilst appropriate for more complex audits, is excessive for many smaller and less complex entity audits and may ultimately be a significant contributory factor impacting the acceptability of ISAs beyond the complex entity audit market.
- Concern as to whether the proposed introduction of PCAOB terminology and its incompatibility with established ISA terms (ISA 200 - reduction of risk to an "acceptably low level" versus "more than remote likelihood") is appropriate for worldwide application. The impact on the work effort is likely to be excessive for audits of small and less complex entities and in our opinion, the compatibility with fundamental terms in extant ISAs has not been sufficiently explored.

Scalability for smaller and less complex entities in the ED is primarily achieved through the application material, rather than the requirements. In our view, besides ensuring that the final standards is fit for purpose for all segments of the audit market, there will be a need for the timely development of additional implementation support for audits of smaller and less complex entities to help mitigate the risk that the proposals will be inconsistently applied. We strongly recommend that the Board consider the establishment

of an implementation working group to provide a resource to respond to the practical challenges, including developing specific examples and illustrations for smaller entities.

DETAILED COMMENTS

We have outlined our responses to the questions (in bold) in the ED below.

Overall Questions

- 1) **Has ED-315 been appropriately restructured, clarified and modernized in order to promote a more consistent and robust process for the identification and assessment of the risks of material misstatement. In particular:**
 - (a) **Do the proposed changes help with the understandability of the risk identification and assessment process? Are the flowcharts helpful in understanding the flow of the standard (i.e., how the requirements interact and how they are iterative in nature)?**

We are very concerned that without the three flowcharts, which are not intended to form part of the final standard, it is very difficult to understand and navigate the standard. This of itself, demonstrates the need for further clarification as described elsewhere in this response prior to finalization. Reference to flowcharts cannot be an appropriate substitute for clear standards. The proposed changes will, without doubt, involve more work and it is essential that for smaller audits to continue being conducted under the IAASB standards, they must be able to demonstrably improve audit quality, instead of adding cost disproportionate to the benefits.

- (b) **Will the revisions promote a more robust process for the identification and assessment of the risks of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6–28?**

The work undertaken to update and modernize the standard in relation to information technology is vital given the fast-paced and evolving business environment. We remain concerned whether the requirements and application material are sufficiently principles-based to effectively address concerns on complexity and scalability.

Besides our comments elsewhere as to the need for the IAASB to ensure the final version of this standard is fit for purpose for all segments of the audit market worldwide, we see room for further improvements. Specifically, we support the requirements of paras 24 and 31(a) for the auditor to evaluate (although this may be an inappropriate term in this context, given the IAASB's glossary definition – “consider” might be more appropriate) whether the entity's accounting policies are, and the nature of the entity's risk assessment process is, respectively appropriate to the entity's individual circumstances. Such an “appropriateness evaluation/consideration” involves the auditor exercising professional judgement, duly taking account of the auditor's understanding, in the light of the individual circumstances of the entity, including its size and complexity and any other relevant factors.

In our view, a similar “appropriateness consideration” would be appropriate beyond these two matters (e.g., regarding the design of controls (para. 26), the appropriateness of the foundation for other components of the system of internal control (para. 28(b)) and of information system controls (para. 36) as well as of control

activities (para. 38)). The IAASB might draw upon ISA 620.08 and use a similar construct in this regard. Focusing on the appropriateness for the specific entity would foster scalability and potentially enhance audit quality as it would also facilitate the auditor identifying and focusing attention on any key control deficiencies within the entity, thus, supporting the requirement of proposed para. 43 (a) for the auditor to determine whether deficiencies have been identified.

(c) Are the new introductory paragraphs helpful?

With one exception, the introductory paragraphs are helpful in understanding the standard and highlight the iterative nature of the auditor's risk assessment process but if the requirements were clearer, they would probably not be necessary.

We are very concerned that the references to smaller and less complex entities are unclear. Despite the explanations, some readers assume that these references are to smaller entities that are also less complex, others assume that they are to smaller entities and less complex entities regardless of their size. If IAASB intends the references to exclude larger entities, it should refer to smaller entities that are also less complex. It should also be made clearer its intention to exclude smaller entities that are complex.

Para 2 of ISA 315 (Revised) states that "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." However, para 13 (n) in ISA 200 only refers to the assertion level, with financial statement level referred to in application material (e.g. para. A36). Furthermore, the proposed requirements regarding assessing the risk of material misstatement at the financial statement level are unclear and this area should thus, be re-considered.

2) Are the requirements and application material of ED-315 sufficiently scalable, including the ability to apply ED-315 to the audits of entities with a wide range of sizes, complexities and circumstances?

According to the [World Trade Organization](#) SMEs represent over 90 per cent of the business population, 60-70% of employment and 55% of GDP in developed economies. The majority of SMEs are 'micro-entities' (1-9 employees) and a significant proportion are family enterprises, which are primarily non-complex where the auditor typically undertakes simple risk assessment procedures.

Overall, we are concerned about the length and complexity of the proposals, and the impact of insufficiently clear or inappropriate terminology on application as discussed elsewhere in this letter. We fear that this means, going forward, risk assessments will involve more work, which may not necessarily improve audit quality and ultimately making ISA audits inefficient from a cost benefit perspective for smaller and less-complex entity audits. We therefore strongly encourage the Board to continue focusing on the scalability of the standard for smaller audits as it works towards finalization. In our opinion, it could be clarified upfront – as in the recently finalized ISA 540 - that the standard can be tailored through the professional judgement of the auditor based on the size, complexity and circumstances of the entity. In this context, we also refer to our response to question 1(b).

We support the placement of matters related to scalability to the start of some sections, so that auditors are able to better consider the material that follows in context. However, whilst we recognize the importance of

auditors fully understanding and reading all the ISAs in order to determine if/ how to apply the relevant content according to different entities circumstances, the volume of material makes this particularly challenging.

We note the approach to building current matters applicable to “considerations specific to smaller entities” into the text of the standard. However, some practitioners are concerned that this has decreased its usability and that this type of signposting is very helpful. The IAASB should consider how the table on scalability in Appendix 1 of the ED is utilized to assist with implementation support. In addition, we note the explanation provided in paragraph 45 of the explanatory memorandum regarding commercial software that cannot be changed by the entity, which will be the case for many small entities. The requirements section does not clearly illustrate that in these circumstances, the auditor may determine that certain controls over IT applications will not be relevant to the audit. We believe that the use of a conditional requirement in this context might be helpful, to help highlight this specific aspect of scalability.

Improvements we support include the differentiation between direct and indirect control components, clarification regarding which controls are relevant to the audit, the introduction of a spectrum of risk and – with certain reservations (see response to question 6 [e]) – the updated definition of significant risks. We also support the references to IT issues in the context of off the shelf packages to which entities do not have the source code.

We specifically support the acknowledgment that communication may be less structured in smaller and less complex entities (A159), the formality of controls may vary (A161) and it may be less practicable to establish segregation of duties (A164).

We are less convinced by the inherent risk factors which overlap considerably, and the definitions of relevant assertions and significant classes of transactions, account balances and disclosures which overlap and seem very convoluted. We do not understand the need to equate a ‘reasonable possibility’ of a material misstatement with one that is ‘more than remote’ and we do not agree that this makes sense in plain English.

We are concerned about the apparent introduction of a new level of risk assessment which involves consideration of ‘potential’ risks before actual risks are considered. In this context, one key concern is that the convoluted drafting (i.e., the use of definitions to set thresholds and use of “requirement type” explanatory material to further impact practice) does not sufficiently clarify the required depth of risk identification.

We are concerned that if practitioners refer to the text of the requirements (but do not have in the back of their minds the details of the related definitions) they may not fully appreciate the thresholds intended to limit the use of professional judgment in determining the “significant class of transactions, account balance or disclosure”. They may miss the fact that it is necessary to read first the definition of “relevant assertion” (which introduces the threshold of more than remote likelihood of occurrence of a misstatement that is either material individually or in combination with other misstatements) and then relate this to the definition of “significant class of transactions, account balance or disclosure” within which “relevant assertion” is included. Using the text of definitions in this way to set this low threshold of more than remote means that

the impact may not be sufficiently clear to practitioners, and this can lead to inconsistency, which we consider should be revisited.

Our reading of the ED leads us to conclude that ED ISA 315 requires a risk identification not only at financial statement level and for inherent risk (which is defined at the assertion level) – both of which are in line with extant ISA 315, but also at a level below assertion level (firm methodologies often call this a “drill down”). Specifically, as explained in para. 62 of the Explanatory Memorandum, the new proposed stand back refers to the need for consideration of whether there could be “one or more risks of material misstatement at the assertion level”. ED ISA 315 A9 states categorically “there will be one or more risks of material misstatement that relate to a (i.e. every) relevant assertion”. Thus, our understanding is that the work effort required involves a drill down identification of every departure from an accounting requirement that could go wrong below assertion level. This is excessive in an SME /less complex entity environment, and if retained, will ultimately be detrimental in terms of achieving a cost-benefit balance for an ISA audit in the smaller and less complex entity audit market. The required use of a drill down is also set forth by the use of the term “identify the risks of material misstatements” in much of the draft, even though a combined risk assessment of inherent and control risks is no longer permitted: if the use of the term means only “the risks of material misstatement at a financial statement level and inherent risks (which are defined only at an assertion level)”, this is what should be used rather than “identify risks of material misstatements”, which would be interpreted as a drill down given the guidance in A9. In this context, we recommend a review of the present tense sentences in the application material, which in practice may be considered to constitute secondary requirements by adding detail to the requirements which they are intended to explain.

We note that there remain fundamentally unresolved differences of opinion regarding the need for auditors to understand controls where a fully substantive audit approach is taken. It would be unfortunate if IAASB’s project on the audit of less complex entities were to find, for example, that there *is* an alternative to mandating work on the design and implementation of controls after finalization of ISA 315 (Revised). The important point for IAASB to consider at this stage is whether all of the new and untested additional material on IT and controls really belongs in the standard itself, in the light of the fact that even larger firms are moving away from testing certain controls, and even analytical procedures, towards extensive tests of details. If this trend is accelerated by advances in the use of data analytics, all of this material may be redundant in a relatively short period of time. Overall, the requirements and application material read more as if they were a large firm methodology than a principles-based standard and we encourage the IAASB to consider how much material can be moved to separate appendices, including, in addition to the material on IT and controls referred to above, considerations specific to public sector entities. The Application Material in para. A38, A79 and A142 are considered overly detailed and may not all be necessary.

The development of further guidance, examples and illustrations will be needed to ensure consistency of application internationally. Now is the time for IAASB to consider producing its own examples as it finalizes the standard, rather than leaving this to national standard-setters and professional accountancy organizations. Examples are particularly necessary for:

- The nature and extent of work on the design and implementation of controls in substantive audits.

- Evaluating where a risk should be placed on the spectrum of risk.
- Documentation of the above and understanding of the business model, the control environment, the entity's risk assessment process and its process to monitor controls.

The SMPC supports the acknowledgement that not all entities will have complete formal documentation of policies and procedures making up their internal control system. We agree that it may be appropriate to recognize the role of actions and decisions. However, IAASB needs to consider further how consistency may be achieved in this context. We are concerned about the potential work effort and related documentation being potentially excessive. This is because the definition of controls includes “such statements may be documented...”, which could be implied to be mandatory and always applicable. Instead, the application material could be used to explain this.

Determining whether an action or decision implies a control may be straightforward where actions and behaviors are repeated over time and form a pattern. However, a single action may be indicative of control but be far from conclusive and auditors should not be encouraged to try and determine the existence or otherwise of controls based on the observance of isolated actions.

3) Do respondents agree with the approach taken to enhancing ED-315 in relation to automated tools and techniques, including data analytics, through the use of examples to illustrate how these are used in an audit (see Appendix 1 for references to the relevant paragraphs in ED-315)? Are there other areas within ED-315 where further guidance is needed in relation to automated tools and techniques, and what is the nature of the necessary guidance?

The SMPC agrees with the IAASB's approach to use the term automated tools and techniques in the ED. We support the view that the term 'data analytics' is too narrow because it may not encompass all of the emerging technologies that are being used when performing a risk assessment and audit procedures.

We recognize this will be further considered as part of the IAASB's forthcoming Audit Evidence project, but believe that it would be very helpful if separate implementation support could be developed to cover existing challenges in practice, for example:

- Guidance on the audit procedures for commercial software that the entities do not have access to the underlying source code.
- Guidance on how to deal with security issues when using the cloud.
- Guidance on how to ensure the integrity of the general ledger from a software package, particularly if the auditor is using a separate data analytics tool.
- Guidance on how to audit primarily online or app businesses and the risks.

4) Do the proposals sufficiently support the appropriate exercise of professional skepticism throughout the risk identification and assessment process? Do you support the proposed change for the auditor to obtain 'sufficient appropriate audit evidence' through the performance of risk assessment procedures to provide the basis for the identification and assessment of the risks of material misstatement, and do you believe this clarification will further encourage professional skepticism?

We agree that the proposals encourage exercise of professional skepticism throughout the risk identification and assessment process, but IAASB should take care in making claims about the power of IAASB standards to change auditor behavior in this respect. We do not believe that the new requirement for 'sufficient, appropriate audit evidence' (para. 17) is helpful in this context to support the identification and assessment of risks of material misstatement at the financial statement and assertion levels. The term is borrowed from requirements concerning the qualitative characteristics of audit evidence more generally and the need to obtain 'evidence about evidence' is more circular than iterative. More importantly, it will likely encourage regulators to encourage auditors to expend unnecessary time and effort documenting why they have not done something. We suggest that additional consideration is also given to what the IAASB and audit regulators will expect to see in terms of the documentation of professional skepticism, as this remains a challenge for practitioners, SMPs or otherwise.

Specific Questions

- 5) Do the proposals made relating to the auditor's understanding of the entity's system of internal control assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks or material misstatement? Specifically:**
- a) Have the requirements related to the auditor's understanding of each component of the entity's system of internal control been appropriately enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?**

We note in our answer to question 2 above, differences of opinion regarding the need for auditors to understand controls where a wholly substantive audit approach is taken. On balance, we agree that some high level understanding of controls, and particularly the controls environment is necessary regardless of the audit approach, but we believe that extent of design and implementation work required under these proposals and the amount of material on controls and IT generally will only reinforce the belief in some quarters that ISAs simply cannot be operationalized efficiently for smaller and less complex audits.

Subject to these considerations, we support the new material relating to the different characteristics of direct and indirect control components, and the clarifications regarding controls relevant to the audit.

It could be made clearer that understanding the control environment is an integral part of understanding the entity and identifying and assessing inherent risk/ the risk of material misstatement, even when the practitioner is undertaking a fully substantive approach to the audit. It is still challenging to assess the extent and depth of work required in this area.

The application material could clarify the differences in work required for evaluating the control environment (req. 27 & 28), the entity's risk assessment process (req. 29-31) and controls relevant to the audit (req. 39-42), which states each control needs to be evaluated to be designed effectively and that it has been implemented. This difference may be helpful to efficiently perform audits of SMEs.

The ED outlines that if the auditor does not contemplate testing the operating effectiveness of controls, or is not required to test controls, control risk is assessed at maximum (para. 50 of the ED). The word

“maximum”, is problematic. It appears to imply a significant problem and an increased risk of material misstatement where in practice, there may be no problem at all. The fact that auditors do not test controls does not make controls weaker, although this is what seems to be implied.

Requirement 21 states that the auditor shall ‘evaluate’ whether information from audit procedures performed in previous audits remains relevant and reliable. We are concerned that ‘evaluate’ implies a higher work effort (e.g. the performance of procedures when necessary), which we do not see as justified. We believe the auditor should be required to apply their mind to the results of procedures that have already been performed, and thus the term “consider” would be more appropriate. In addition, it could be made clearer whether testing results of operating effectiveness of controls from prior periods remain valid upon making assessment of control risks. In addition, we question why “and reliability” has been added as a conforming change to ISA 330 para. 14. In our view, audit evidence can lose relevance, but not reliability; so it does not seem logical to include it.

b) Have the requirements related to the auditor’s identification of controls relevant to the audit been appropriately enhanced and clarified? Is it clear how controls relevant to the audit are identified, particularly for audits of smaller and less complex entities?

The listing of controls relevant to the audit are helpful although the catch all category of ‘other controls’ without further elaboration is a recipe for stand-off between auditors and regulators. In our opinion, there should be specific acknowledgement that in audits of smaller and less complex entities, in which a fully substantive approach is taken, there are likely to be few controls relevant to the audit that are appropriate to evaluate for their design and implementation. However, it is important also to note that evidence regarding assertions such as completeness and evidence about data integrity more widely, or that recorded transactions cannot be changed, is often missing in some so-called ‘substantive’ audits.

Because paragraph 39 (b) determines that internal controls that address significant risks are relevant to the audit, the auditor will be required to test the design and implementation of these controls, even if the auditor does not intend to rely on them and will set control risk at maximum. We agree that this may be appropriate for significant risks that involve complexity so that auditors are in a better position to assess inherent risk, but question whether this is necessary for significant risks not subject to complexity when auditors believe that they can respond to the risks of material misstatement through substantive procedures alone.

Similarly, we question whether an auditor in an SME environment will always need to understand the nature of controls relating to managements risk assessment process, or its monitoring of controls (para. 39(e)).

c) Do you support the introduction of the new IT-related concepts and definitions? Are the enhanced requirements and application material related to the auditor’s understanding of the IT environment, the identification of the risks arising from IT and the identification of general IT controls sufficient to support the auditor’s consideration of the effects of the entity’s use of IT on the identification and assessment of the risks of material misstatement?

We note in our answer to question 2, above, our concerns regarding the increase in material on IT and controls at a time at which even larger firms are moving towards tests of details. While we support the new coverage in principle, the new IT-related concepts and definitions and the application material all warrant

further work in order to simplify them. A lack of work on IT systems, which is a significant area in many audits reflects a lack of appropriate professional skepticism that the ED seeks to remedy. However, it will require considerable implementation assistance to operationalize.

Terminology in this area is notoriously loose and fast moving and we fear that if IAASB does not move some of this material to appendices, it is likely to cause confusion and potentially lead to rapid redundancy. Given the length of application material, it would be helpful if more prominence at an early stage could be given to what aspects are relevant to situations in which an entity uses an off-the-shelf accounting package with limited or no modifications.

6) Will the proposed enhanced framework for the identification and assessment of the risks of material misstatement result in a more robust risk assessment? Specifically:

a) Do you support separate assessments of inherent and control risk at the assertion level, and are the revised requirements and guidance appropriate to support the separate assessments’?

In general we support separate assessments of inherent and control risk at the assertion level. One concern is that it may lead to risks of material misstatement being overstated if inherent risks are no longer allowed to be reduced or mitigated by effective controls.

It does not appear reasonable to require auditors to identify relevant assertions based on a combined identification of both inherent and control risks (the risk of material misstatement) in order to identify significant classes of transactions, account balances and disclosure and, in turn, to identify relevant controls.

When identifying relevant assertions, the identification of whether a reasonable possibility of occurrence exists ought to be based on inherent risk alone and not on the combined inherent and control risk.

In addition, both the auditor’s risk identification and assessment would need to differentiate between inherent and control components. The overall risk assessment flowchart shows the identified risks at the assertion level as one step (cross-referenced to para 45 (b)), only to split the steps to inherent and control for assessment (cross-referenced to paras. 48 and 50 respectively) subsequently. It does not seem logical to assess distinct risks unless they have first been identified as distinct.

b) Do you support the introduction of the concepts and definitions of ‘inherent risk factors’ to help identify risks of material misstatement and assess inherent risk? Is there sufficient guidance to explain how these risk factors are used in the auditor’s risk assessment process?

We have concerns about the introduction of the ‘inherent risk factors’ to help identify risks of material misstatement and assess inherent risk because of the degree of overlap between them and the associated documentation requirements. We believe these may be better expressed in application material and in developing implementation support, it would be helpful to explain the nature and extent of the required documentation, including ‘implied’ controls.

In order to assist practical application, it would be helpful to clarify under 'Uncertainty' in A5 that "best available" is relative to the audit i.e. the best available to the auditor.

- c) In your view, will the introduction of the 'spectrum of inherent risk' (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks?**

In our view, the introduction of the 'spectrum of inherent risk' reflects what already happens in practice. We support the IAASB's retention of, and requirement to, determine significant risks.

However, we are not convinced the introduction of the spectrum will assist in achieving greater consistency in the identification and assessment of risk, including significant risks. There is a concern that the requirements do not deal with the spectrum very thoroughly and so it is not clear what is required of auditors. The definitions mention "high end of the spectrum", but it may not be easy to determine exactly where a threshold lies. All stakeholders (auditors, audit inspectors, professional accountancy organizations) will need to engage in substantial discussions regarding the application of professional judgement in this area.

- d) Do you support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and their relevant assertions? Is there sufficient guidance to explain how they are determined (i.e., an assertion is relevant when there is a reasonable possibility of occurrence of a misstatement that is material with respect to that assertion), and how they assist the auditor in identifying where risks of material misstatement exist?**

We have a number of concerns as to the proposed introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures and their relevant assertions as they stand as they are unnecessarily convoluted and warrant further rationalization prior to finalization.

We do not believe that introduction of PCAOB terminology to set thresholds for risk assessment and risk response (see the definition of "relevant assertions") is either warranted or appropriate for ISAs designed for world wide application in audits of all entities. The IAASB needs to explain whether, and, if so, how it believes that PCAOB concepts and thresholds align with extant ISAs. In relation to audit risk, the overall objective of ISA 200 uses the term "acceptably low level", whereas the introduction of PCAOB terminology implies this threshold is amended to "a remote possibility". The proposed changes will have a significant impact in practice as the proposed conforming amendments to ISA 330, applied in an iterative risk response process will result in auditors performing risk response procedures until risks of material misstatement are remote.

Further, we do not support the notion that 'reasonably possible' can be equated with 'more than remote'. We are concerned this will result in inconsistent application, especially upon translation. It also lowers the threshold without a corresponding increase in audit quality and may also impact the ISAs notion of "acceptably low level" of audit risk and thus have a very significant impact.

- e) Do you support the revised definition, and related material, on the determination of 'significant risks'? What are your views on the matters presented in paragraph 57 of the**

Explanatory Memorandum relating to how significant risks are determined on the spectrum of inherent risk?

We support the revised definition, and related material, on the determination of 'significant risks', which should be more straightforward to apply in practice. We agree that significant risks should not be limited to risks with a high magnitude and likelihood. Similar to assessment of inherent risks, we believe that the likelihood of occurrence and magnitude of potential misstatements should be considered collectively to make a conclusion as to whether a risk constitutes "significant risk" as opposed to the use of a rigid definition. In our view, there is a need for the IAASB to be explicit about what it intends in regard to the auditor's approach to likelihood vs likelihood or magnitude, since we are aware of different interpretations of the IAASB's assumed intent. Lack of clarification in this area will lead to inconsistent application. For example, the possible impact on an entity's ability to operate as a going concern is a factor that could be highlighted in this regard, to clarify that even a low likelihood can be a trigger.

7) Do you support the additional guidance in relation to the auditor's assessment of risks of material misstatement at the financial statement level, including the determination about how, and the degree to which, such risks may affect the assessment of risks at the assertion level?

We are concerned that the complexity and inconsistent use of terminology will lead to considerable confusion. Furthermore, documentation of this assessment of risks of material misstatement at the financial statement level will be highly subjective and lead to inconsistencies in practice.

8) What are your views about the proposed stand-back requirement in paragraph 52 of ED-315 and the revisions made to paragraph 18 of ISA 330 and its supporting application material? Should either or both requirements be retained? Why or why not?

Differing views were expressed on the proposed and extant stand-back requirements. While they fulfil two different purposes, many consider that neither is necessary. If the risk assessment is performed properly, proposed paragraph 52 is unnecessary. Extant paragraph 18 in ISA 330 generates dysfunction in that notional substantive procedures are performed for compliance purposes only. On balance, we suggest that both are retained, but as application material.

We do not support the use of the terms 'quantitatively or qualitatively' in the context of materiality as, by definition, it covers both aspects.

Consideration should be given to the importance and use of the terms 'material' and 'significant'. For example, in Japan the translations are the same, so more explanation is needed.

Conforming and Consequential Amendments

9) With respect to the proposed conforming and consequential amendments to:

a) ISA 200 and ISA 240, are these appropriate to reflect the corresponding changes made in ISA 315 (Revised)?

In our opinion, the references to ISA 240 and conforming amendments appropriately underscore the importance of the consideration of fraud when identifying and assessing risks of material misstatement in accordance with ISA 315 (Revised) and no further changes are needed.

- b) ISA 330, are the changes appropriate in light of the enhancements that have been made in ISA 315 (Revised), in particular as a consequence of the introduction of the concept of general IT controls relevant to the audit?**

The content of responses to risks at the financial statement level is not comparable to the level of the description related to risk assessment of the risks at the financial statement level. In addition, the relationship between these procedures at ISA 330 (A1 – A3) and the procedures in ISA 240 are unclear.

Our main concern relating to ISA 330 is however that the proposed changes to ISA 330.7 in combination with the introduction of the PCAOB threshold “more than remote likelihood” will, given the iterative nature of risk response, result in the performance of excessive work. We refer to our more detailed explanation above in this respect.

- c) The other ISAs as presented in Appendix 2, are these appropriate and complete?**

The other ISAs are considered appropriate and complete.

- d) ISA 540 (Revised) and related conforming amendments (as presented in the Supplement to this exposure draft), are these appropriate and complete?**

ISA 540 (Revised) and related conforming amendments are considered appropriate and complete.

- 10) Do you support the 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?**

As noted in response to question 8, we do not support the use of the terms ‘quantitatively or qualitatively’ in the context of materiality as it covers both aspects. The additional level of precision may impact practice if it leads to regulators demanding documentary evidence that the auditor has considered each and every item separately in terms of both quantitative and qualitative factors

Request for General Comments

- 11) In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters set out below:**

- (a) Translations—recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-315.**

In some languages (e.g. Japan) the word ‘significant’ may be translated using the same word as ‘material’, even though they have specific meanings in the context of the ISAs. Consideration could be given to instances of using words with similar meaning in close proximity in order to assist more consistent understanding and application in practice.

- (b) Effective Date—Recognizing that ED-315 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final ISA. Earlier application would**

be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.

Given the time required for national due process, translation and implementation (including training) an effective date for the standard for financial reporting periods of at least 18 months after the approval of a final ISA is the minimum timeframe that should be considered adequate. As the standard is very long and complex, the translation work for jurisdictions not using the English version will need additional time. We therefore consider that a longer period to the effective date might be more appropriate.

We encourage the IAASB to publish the final document in draft form (ahead of PIOB approval) as was done for ISA 540 (Revised) to facilitate adoption processes at a national level.

CONCLUDING COMMENTS

We hope that the IAASB finds this letter useful. We are committed to helping the Board in whatever way we can to build upon the results of the Exposure Draft.

Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,



Monica Foerster

Chair, SMP Committee