



**EXPOSURE DRAFT, ISA 315 (REVISED),  
IDENTIFYING AND ASSESSING THE RISKS OF  
MATERIAL MISSTATEMENT**

**Response from ICAS to the IAASB**

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## **Background**

ICAS is a professional body for more than 21,000 world class business men and women who work in the UK and in more than 100 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader.

Almost two thirds of our working membership work in business; many leading some of the UK's and the world's great companies. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest.

ICAS was created by Royal Charter in 1854.

## **General comments**

We welcome the opportunity to respond to the IAASB Exposure Draft (ED), ISA 315 (revised), identifying and assessing the risks of material misstatement.

We acknowledge the IAASB's objective to improve extant ISA 315 in order that it can be understood and implemented in a more consistent manner. However, we are not convinced that this objective has been achieved. In general, it is our view that the ED is unnecessarily long; difficult to follow; does not achieve the objective of being sufficiently scalable; and is more prescriptive than would be expected of a principles-based standard.

Additionally, the statement in paragraph 8 of the Explanatory Memorandum that the audit risk model is fundamentally sound, and the revisions to ISA 315 are intended to encourage auditors to perform better risk assessments, does not appear to be consistent with the concept of principles-based standards as this suggests the introduction of a more prescriptive approach to the risk assessment process.

We would therefore suggest that the ED might need a substantial re-write and acknowledge that this is likely to require a significant amount of the IAASB's time and further delay to the finalisation of the revised standard, as it may, as a result, require to be re-exposed. While this is regrettable, it is perhaps necessary in order to ensure that the quality of the final standard is not sacrificed in favour of timeliness.

We do not disagree with all of the changes proposed in the ED. In fact, a number of them are welcome. We particularly recognise the value of the greater emphasis placed on the importance of the applicable financial reporting framework as part of the auditor's understanding of the entity as a positive step.

We also welcome the use of the revised terminology of smaller and less complex entities as the reference in the current standard, which is limited to small entities, does not acknowledge that there may be some small entities with some complex issues and, equally, larger entities with no complex issues.

Paragraph 38 of the ED now includes a reference to controls relevant to the audit and this is a welcome and helpful addition as it highlights the need to consider controls over the use of journal entries which will always be relevant to the audit.

However, as our membership comprises many smaller audit firms, we are particularly disappointed that the specific headings ***‘Considerations specific to smaller and less complex entities’*** have been removed in the ED and would prefer that these references are retained within a separate heading: ***Smaller and less complex entities***; within the revised standard. This would enable auditors of such entities to easily identify the relevant paragraphs without having to refer to the full body of the standard, which is contradictory to the objective for the ED to be sufficiently scalable.

We note the comment in paragraph 4 of the Explanatory Memorandum to the ED regarding the scalability challenges faced by auditors of SMEs when applying extant ISA 315, in particular those related to the extent of work to be performed when the auditor does not intend to rely on the operating effectiveness of the entity’s internal controls. We do not identify with this as one of the key limitations of extant ISA 315.

We also highlight that the iterative process of ISA 315 and the performance of the risk assessment does not lend itself easily to a linear standard as the Explanatory Memorandum has acknowledged. The three flowcharts that have been produced to accompany the standard are intended to improve the understanding and the flow of ED-315. We are not against the use of flowcharts as a rule, however, in this case we do not believe that they are particularly helpful in assisting with the navigation or understanding of the standard due to the undue complexity of ED-315 that would justify their inclusion. We strongly believe that flowcharts should not be required as an alternative to reading the full standard. As such, we would suggest that greater effort is devoted to the improvement and simplification of ED-315 and the need for flowcharts should be considered at a later stage in the revision of the standard.

With regard to the introductory paragraphs, we believe that these merely confirm matters of which the auditor should already be aware and therefore do not see any value in their inclusion. They also add unnecessarily to the length of the standard.

In relation to how the use of automated tools and techniques, including audit data analytics, might be incorporated within ISA 315, much of this will be determined based on the auditor’s judgement and the revisions only make reference to the use of such tools and techniques without explaining the impact of their use on the risk assessment or audit process. However, we acknowledge that ISA 500 might be more appropriate for dealing with this issue.

The section on IT controls and applications does rather state the obvious and demonstrates how the standard is becoming too explicit and excessively prescriptive by removing some of the reliance on the application of professional judgement. Some of this might be better located in the application material if retained at all.

We do not consider the inclusion of the concept of a spectrum of inherent risk helpful in facilitating and identifying the level of inherent risk. The determination of the level of inherent risk may be less problematic for smaller and less complex entities, than for listed entities where greater judgement will be necessary in determining exactly where they should sit on such a spectrum, and therefore further clarification and explanation of this concept and its application is required.

Paragraph 52 of the ED demonstrates the subtle change in the direction of travel on the part of the regulator and standard setter. It now places more reliance on the need for evidence and documentation as to how the auditor has reached his/her conclusion and satisfied himself/herself that nothing has been overlooked as opposed to a matter for the auditor’s professional judgement which will be based on all the facts and information available at the time.

With regard to the inclusion of the stand-back requirement itself, we believe that this is already performed in practice, but further detail on who might perform the stand-back, at what stage and how it should be performed would be helpful.

In relation to the conforming amendments, at this stage it may be premature to consider these in detail on the basis of our initial remarks on the quality of the ED. However, in relation to ISAs 200 and 300, we reiterate our concerns about the introduction of a spectrum of risk and make reference to our observations in relation to the use of automated tools and techniques as part of the revision of ISA 500.

Our responses to the specific questions in the ED are detailed below.

## **Overall Questions**

### Question 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)?
- (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?
- (c) Are the new introductory paragraphs helpful?

### Response 1

- a) As stated in the general comments section, the iterative process of ISA 315 and the performance of the risk assessment does not lend itself easily to a linear standard as the Explanatory Memorandum has acknowledged. The three flowcharts that have been produced to accompany the standard are intended to improve the understanding and the flow of ED-315. We are not against the use of flowcharts as a rule, however, in this case we do not believe that they are particularly helpful in assisting with the navigation or understanding of the standard due to the undue complexity of ED-315 that would justify their inclusion. We strongly believe that flowcharts should not be required as an alternative to reading the full standard. As such, we would suggest that greater effort is devoted to the improvement and simplification of ED-315 and the need for flowcharts should be considered at a later stage in the revision of the standard.
- b) We do not believe that the revisions provide a more robust process for the identification and assessment of the risks of material misstatement as we consider that they remove the need and ability for the auditor to exercise professional judgement as part of a principles-based approach and as such ED-315 has become much more prescriptive in nature.
- c) With regard to the introductory paragraphs, we believe that these merely confirm matters of which the auditor should already be aware and therefore do not see any value in their inclusion. They also add unnecessarily to the length of the standard.

### Question 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?

### Response 2

We welcome the use of the revised terminology of smaller and less complex entities as the current reference, which is limited to small entities, does not acknowledge that there may be some small entities with some complex issues and, equally, larger entities with no complex issues.

However, we are disappointed that specific references to smaller and less complex entities have been removed in the ED and would prefer that these references are retained within a separate heading: ***Smaller and less complex entities***; within the revised standard. This would enable auditors of such entities to easily identify the relevant paragraphs without having to refer to the full body of the standard, which is contradictory to the objective for the ED to be sufficiently scalable.

### Question 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?

### Response 3

With regard to how the use of automated tools and techniques, including audit data analytics, might be incorporated within ISA 315, much of this will be determined based on the auditor's judgement and the revisions only make reference to the use of such tools and techniques without explaining the impact of their use on the risk assessment or audit process. However, we acknowledge that ISA 500 might be more appropriate for dealing with this issue.

Although the use of automated tools and techniques is becoming more widespread, at least at a basic level, the standard should make it clear that the use of such techniques in the risk identification and assessment process is not a requirement, since many small or medium practice firms do not have access to automated tools and techniques. Furthermore, the ED could highlight that the use of data analytics techniques and automated tools and techniques do not increase the work effort required in the risk assessment and identification process, as leveraging on their use might replace some of the current procedures.

### Question 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?

### Response 4

With regard to the reference to the appropriate exercise of professional skepticism throughout the risk identification and assessment process, we note that ED-315 currently only includes a reference to that term without any emphasis on the need for the auditor to adopt a skeptical mindset as a behavioural issue. Whilst we acknowledge that it should not be the purpose of a standard to prescribe how professional scepticism should be applied, the emphasis on the need for professional skepticism to be applied throughout the risk identification and assessment process could be stronger.

## Specific Questions

### Question 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?
- 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?
- 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?

### Response 5

- a) We agree that the auditor's understanding of each component of the entity's system of internal control, if it is relevant to financial reporting, is a prerequisite of assessing control risk during the risk identification and assessment process.

However, from a scalability perspective, we do not consider that understanding and documenting all components of the entity's internal control system or assessing the design and implementation of controls, is required for entities in a simple and low-risk environment for which a full substantive audit approach will be adopted. Requiring such work could prevent the auditor's resources being applied to more valuable aspects of the audit and potentially result in significant audit documentation which is of little value and could obscure the real audit issues.

- b) Following on from the point above, having undertaken the assessment of the control system for a small, low-risk entity, auditors might conclude that there are relatively few controls relevant to the audit and might adopt a fully substantive approach. Therefore, we consider that the requirement to identify controls relevant to the audit, evaluate their design and determine whether they have been implemented, is of limited value in the audits of such entities where a fully substantive audit approach is believed to be the most appropriate audit strategy.
- c) While we support the introduction of the new IT-related concepts and definitions, we believe that the section on IT controls and applications does rather state the obvious and demonstrates another example of how the standard is becoming too explicit and removing some of the reliance on the application of professional judgement. Some of this content might be better located in the application material if retained at all.

We would also welcome a conditional paragraph to introduce an exception in the case of entities in a simple and low-risk environment using only 'off-the-shelf' software packages. The standard should be clearer on the work effort required from practitioners in such cases – e.g. a minimum requirement to assess the modifications or updates made to an off-the-shelf software package.

### Question 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?
- 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?
- 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?
- 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?
- 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?

#### Response 6

- a) The separate assessments of inherent and control risk at the assertion level are inevitable and the revised requirements and guidance thereon is appropriate to support the separate assessments. This is also a logical consequence of the approach taken in revised ISA 540, as recently approved. We would also like to point out that logically it will also be necessary to identify inherent risk separately from control risk in order to perform such an assessment.
- b) The concept of 'inherent risk factor' and its definition is consistent with ISA 540. ED-315 provides sufficient guidance to explain how these risk factors are used in the auditor's risk assessment process.
- c) We do not consider the inclusion of the concept of a spectrum of inherent risk helpful in facilitating and identifying the level of inherent risk. The determination of the level of inherent risk may be less problematic for smaller and less complex entities, than for listed entities where greater judgement will be necessary in determining exactly where they should sit on such a spectrum and therefore further clarification and explanation of this concept and its application is required.
- d) We find the new definitions difficult to read and follow. Overall, the standard is difficult to understand and needs significant improvements to give more clarity to the concepts used and to eliminate repetition.

We also note the introduction of the PCAOB terms 'more than remote' and 'reasonable possibility' in the ED and question whether this may have unintended consequences in relation to the work effort perceived necessary to meet these requirements.

- e) In general, we support retaining the notion of 'significant risk', but when using the 'spectrum of inherent risk' in risk assessment, the notion of 'significant risks' may be seen as redundant. However, we appreciate that not retaining the notion of 'significant risks' would cause disruptions in the suite of ISAs. That said, we believe that defining 'significant risks' as risks closer to the upper end of the 'spectrum of inherent risk' is not sufficient to address this issue and may need further consideration.

#### Question 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?

### Response 7

We do not find the additional guidance in relation to the auditor's assessment of risks of material misstatement at the financial statements level sufficiently clear or explanatory. Rather than being applicable in practice, this guidance is superfluous and does not necessarily fit naturally within the application material. This is another example of material that leads to the standard being unnecessarily lengthy and complex.

### Question 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?

### Response 8

With regard to the inclusion of the stand-back requirement itself, we believe that this is already performed in practice, but further detail on who might perform the stand-back, at what stage and how it should be performed would be helpful. We would suggest that this process could be performed at an earlier stage, perhaps at the planning stage, of the audit process.

## **Conforming and Consequential Amendments**

### Question 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)?
- 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?
- c) The other ISAs as presented in Appendix 2, are these 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?

### Response 9

The revision of ISA 315 will have a significant impact on the revision of future standards. Therefore, before addressing the conforming and consequential amendments from the revision of this standard, our concerns regarding the current ED-315 need to be resolved such as its unnecessarily complex construction and the issues around scalability.

To address some of the specific aspects of this question, on point a) above, we consider the ISA 200 definition of 'small entities' to be sufficient for the time being, while on point b) above, we note that further work is required to promote the use of data analytics as part of the revision of ISA 500. We also reiterate our concerns regarding the introduction of the concept of a 'spectrum of inherent risk' in relation to conforming amendments to ISAs 200 and 300.

### Question 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? See footnote 26 of this Explanatory Memorandum Paragraphs 16(k) and A10, and A229–A231, of ED-315 ED-315, paragraphs 47 and A215–A220 Conforming amendments to ISA 200, paragraph A42 will be presented with the conforming amendments to ISA 540 (Revised) to be published in late July 2018.

### Response 10

We believe that materiality is already well understood as having quantitative and qualitative components, therefore do not believe that it is necessary for ED-315 to be so explicit in this regard. We would however welcome an emphasis on the use of professional judgement in these instances.

### **Request for General Comments**

### Question 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.
- 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.

### Response 11

- a) The proposed revised standard is very difficult to understand and needs significant improvements to ensure that it is sufficiently clear and capable of implementation. The IAASB should ensure that the terminology used in the standard is consistent with the other ISAs and capable of being properly translated. The inability to understand the language used will in turn lead to inconsistencies in translation. We would urge the IAASB to bear this in mind when drafting revised standards as well as when setting their effective dates.
- b) It is crucial that the process to revise this standard is given sufficient time to resolve the difficulties we have highlighted in understanding and following the ED and to address the issues around scalability. As a result, we believe that the IAASB should set a more realistic timeline for revising this standard.