

November 2, 2018

Mr. Dan Montgomery  
Technical Director  
International Auditing and Assurance Standards Board  
International Federation of Accountants  
585 Fifth Avenue – 14th Floor  
New York, NY 10017  
U.S.A.

Dear Mr. Montgomery,

**Re: IAASB Exposure Draft Proposed ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement**

The Canadian Auditing and Assurance Standards Board (AASB) is pleased to provide its comments on the proposed International Standard on Auditing 315, *Identifying and Assessing the Risks of Material Misstatement* (ED-315).

In developing our views, we wanted to bring a practical perspective to our deliberations. We asked a selected number of audit firms and organizations of various sizes to field test ED-315 to better understand the practical implications of the proposals. That insight, as well as feedback provided by Canadian stakeholders through roundtable sessions, has informed the views we express in this response. [Appendix I](#) includes a summary of the Canadian consultations on ED-315.

In our response, “stakeholders” refers to Canadian stakeholders who provided us with input. Also, “we” refers to the AASB.

We applaud the IAASB’s significant effort to strengthen identifying and assessing the risks of material misstatement. We acknowledge that developing this exposure draft was a difficult task due to the complexity of the issues under consideration.

Overall, we and our stakeholders agree that the proposed changes are an improvement over the extant ISA, and that the changes bring clarity to many issues, such as how the understanding of the entity, its applicable financial reporting framework, and the system of internal control drive consideration of the risks of material misstatement.

We believe, however, that for ED-315 to promote a more consistent process for the identification and assessment of the risks of material misstatement, further improvements are needed. The results of field testing showed that many Canadian practitioners had significantly different interpretations of certain aspects of the proposals. In particular, we are concerned about the following:

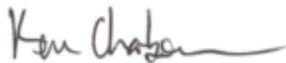
- *Understanding versus evaluating the design of components of internal control* - It's not clear how the auditor evaluates the control components "Control Environment" and "The Entity's Risk Assessment Process". The requirements and application material to these components indicate the auditor may identify control deficiencies. However, other application material indicates these are indirect components where the auditor may not identify controls relevant to the audit and therefore may not perform design and implementation procedures. We suggest the term "assess" be used in place of "evaluate" in these circumstances. [Please see our response to Q5a for further details].
- *Controls relevant to the audit in accordance with paragraph 39(e)* - There are two very different interpretations of the requirement in paragraph 39(e) to identify controls relevant to the audit that, in the auditor's professional judgment, would enable the auditor to identify and assess the risks of material misstatement. Some practitioners had the view that many controls would be identified as relevant to the audit (i.e., all "in scope" or "significant" financial statement line items would have controls relevant to the audit identified under this requirement), while others said they would rarely identify any controls under the requirement in paragraph 39(e). The different interpretations would result in a significant inconsistency in practice. We suggest the IAASB clarify its expectation on paragraph 39(e). [Please see our response to Q5b for further details].
- *Lack of clarity in the "information system and communication" component of internal control (paragraphs 35-36)* – in particular the extent of understanding required; the controls the auditor would identify and how these controls would differ from those identified under the requirement to perform design and implementation procedures over controls relevant to the audit (paragraph 42); and the impact on the audit when the methods and controls used by the entity to generate information are weak. [Please see our response to Q5c for further details].
- *Significant risks and the reference to magnitude "AND" likelihood* - there was concern with using OR in the definition (paragraph 16k), as some would interpret the situation of high magnitude but low likelihood as always being a significant risk, while others would interpret it as a rare circumstance. This would result in inconsistency in practice. Also, an unintended consequence may be an increase in the number of significant risks that auditors identify in their audits, where attention may not need to be directed. [Please see our response to Q6e for further details].

- *Stand-back requirements* - we support the stand-back in ED-315 but believe it should be removed from ISA 330 to reduce confusion and different interpretations that exist today about the purpose of the stand-back in ISA 330. [Please see our response to Q8 for further details].

Please see [Appendix II](#) for our detailed response to each question asked in ED-315. Editorial comments have been provided directly to the IAASB staff.

We hope that these comments will be useful to the IAASB in determining the appropriate next steps relating to this key project. If you have any questions or require additional information, please contact Eric Turner at (416) 204-3240 or [eturner@iasbcanada.ca](mailto:eturner@iasbcanada.ca)

Yours very truly,



Ken Charbonneau FCPA, FCA  
Chair, Auditing and Assurance Standards Board (Canada)

c.c. Canadian Auditing and Assurance Standards Board members

Ron Salole, member of the International Auditing and Assurance Standards Board

## Appendix I: Summary of consultations on the IAASB’s Exposure Draft of ISA 315 (Revised)

### I. Groups consulted

- Advisory Group to the AASB on the project to revise Identifying and Assessing Risks of Material Misstatement
- Regulators
- Large Firms
- Practitioners in small and medium-sized practices
- Legislative auditors
- Provincial CPA body working group on assurance and reporting

### II. Summary of field testing conducted by practitioners in Canada

#### Exhibit I –Significant Classes of Transactions, Account Balances and Disclosure and industries referenced

SCOTABADs field tested	Industries
Employee Benefits	- Government - School district
Expenses (Scholarships, bursaries, etc.)	- University
Revenue	- Aerospace - Condominium Corporation - Construction - Customs Brokerage - Digital Marketing - Distribution - Golf Club - Manufacturing - Mining - Retail - University

## Appendix II: Request for Specific Comments

**Q1) *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:***

Generally, we agree that ED-315 is appropriately restructured, clarified and modernized. One example that we believe modernizes the standard is the use of flowcharts. Stakeholders indicated the flowcharts helped them navigate through the materials which some saw as long and complex. Even though some stakeholders had concerns with the length of the standard overall, we believe it is appropriate given that it sets the foundation for a complex topic.

Areas where we still have concerns or require clarification are detailed in our responses below.

**Q1(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)?***

In part. While we support that many of the changes proposed in ED-315 will improve the understandability of the risk identification and assessment process, there are certain areas that we believe should be improved. See our responses to questions 5 and 6 for more details on areas for improvement.

We support the use of flowcharts and all stakeholders requested that they be made part of the final standard. We believe the flowcharts are a fundamental tool in helping auditors understand this complex standard. Participants of the field testing indicated they would use the flowcharts as a continuing guide as they work through the risk identification and assessment phase of the audit. Stakeholders also found the graphic on page 20 of the explanatory memorandum very useful and believe it should be made part of the final standard.

As discussed in the response to Q2 below, our stakeholders still found it difficult to determine what was required when the entity has a simple IT environment. We suggest the IAASB consider creating a companion piece to the flowchart “The Auditor’s Understanding of the IT Environment and the Identification of General IT Controls Relevant to the Audit” to show what would be expected in an audit where the entity uses commercial software in a simple IT environment and does not have access to make any program changes.

**Q1(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?**

Yes, we agree that the proposals will promote a more robust risk assessment process compared to the extant ISA 315. The proposals address the areas in the extant standard that we previously identified are causing confusion for auditors in performing audits.

The public interest considerations outlined in the explanatory memorandum include the complexity of the standard, scalability, modernization, professional skepticism, and the linkage to the auditor’s considerations of fraud. Each of these considerations is covered by a separate question and our response is included in Q1, Q2, Q3, Q4, Q5(c) and Q6(b).

**Q1(c) Are the new introductory paragraphs helpful?**

We support the new introductory paragraphs. Stakeholders commented that these paragraphs were a useful “executive summary” of the requirements and provided context for what they should expect later in the standard. They help explain the iterative nature of the proposed standard.

**Q2) 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?**

In part. There are areas of the proposals that we believe enhance the scalability of the standard, but we have identified some challenges as well.

An area where we support the scalability of ED-315 is:

Application material specific to smaller and less complex entities

We support the use of the term “smaller and less complex”, and the change in structure of the application material in ED-315 to move the material relating to smaller and less complex entities close to the front of the related section. Although we have heard from some stakeholders that they want a quick answer or short-cut through the application material for auditing a small and less complex entity, we believe that is not the purpose of application material. We believe a weakness of sign-posting the application material for small and less complex entities is that some practitioners do not read all the material in the standard when provided with headings to point to specific sections.

We note that the approach to application material specific to small and less complex entities in ED-315 is different compared to the approach followed by the IAASB in ISA 540 (Revised). In 540 (Revised) there are headings for “Scalability” and no references to “smaller and less complex”. We believe using a consistent approach to draft the ISAs would improve clarity and understandability.

Based on feedback provided by our stakeholders, we offer suggestions below as to how ISA 315 could be made more scalable:

New introductory material to describe the benefit of evaluating design and determining implementation of controls relevant to the audit (D&I procedures)

Paragraph 6 of ED-315 emphasizes that if the auditor does not intend to test the operating effectiveness of controls, control risk is assessed at maximum. While we agree with this statement, we believe there is benefit and value to performing D&I procedures. Practitioners who primarily perform substantive only audit engagements indicated that paragraph 6 led them to believe there would be no difference in substantive procedures for audits of entities which have controls that are designed effectively and implemented, versus audits of entities with poor or no controls. We encourage the IAASB to consider adding a statement in the introductory paragraphs that links to the material in paragraph A200 which articulates the benefit and value of performing D&I procedures.

Application material relating to the IT environment for smaller and less complex entities

Stakeholders believe that the material relating to understanding the information system, IT applications and other aspects of the entity's IT environment that are relevant to the audit was not clear when the entity being audited operates a simple IT environment. They found the application material relating to IT overwhelming and were not able to focus on what was really required in simple environments. We believe the application material relating to IT should be reviewed again in the context of auditing a smaller and less complex entity to determine if there are improvements that could be made to guide practitioners through this complex topic. Another option, as suggested in the response to Q1(a) above, could be to create a simplified version of the IT environment flow chart to assist with this understanding.

Coordination between the projects on Audits of Less Complex Entities and ISA 315

We know the IAASB project on Audits of Less Complex Entities plans to issue a discussion paper in Q2 of 2019. We believe this discussion paper could focus on challenges in practically applying ISA 315. The results of comments received on ED-315 could inform the discussion paper on Audits of Less Complex Entities and the related questions posed within that discussion paper.

- Q3) *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?***

Yes, we support the approach taken in relation to automated tools and techniques. We agree it should be acknowledged and kept general as changes in this area happen quickly. This is the best approach to future proof the standard.

**Q4) *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?***

Yes, the proposals sufficiently support the appropriate exercise of professional skepticism throughout the risk identification and assessment process. Participants of the field testing indicated that it was not only the six specific references to professional skepticism (highlighted in Appendix 1 of the explanatory memo) that may drive the appropriate exercise of professional skepticism. The robustness of the standard taken as a whole will also serve to improve the exercise of professional skepticism.

We also support the reference to “sufficient appropriate audit evidence” (paragraph 17) to provide the basis for the identification and assessment of the risks of material misstatement. We believe this reference will encourage the exercise of professional skepticism because it reinforces the need for the auditor to consider whether inquiry-based procedures will provide the evidence they need to support the risk assessment.

**Q5) *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:***

**Q5(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?***

While we agree ED-315 enhanced the requirements related to the auditor’s understanding of each component of internal control, we believe there are items that should be clarified. Key areas where field testing participants expressed different interpretations are detailed below. We suggest all comments accepted by the IAASB should also be reflected in the flow charts in the final standard.

### Lack of clarity on whether inquiry alone is sufficient to understand indirect components

Paragraph A20 indicates that the auditor need not perform all the risk assessment procedures for each aspect of the understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control. Some participants of the field testing thought inquiry alone would be sufficient for the understanding of the components of internal control while others thought more was needed.

The ISA 315 Task Force Chair indicated in the IAASB's Q&A webinar on October 3, 2018 that inquiry alone was not sufficient because of the guidance in ISA 500.A2. However, that guidance refers specifically to "inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level...", which could be interpreted as only relating to the audit procedures that are designed to respond to the assessed risk.

We encourage the IAASB to provide clarity on whether observation and inspection is expected to be performed when obtaining an understanding of the indirect components of internal control (control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control).

### Understanding, versus evaluating the design of, components of internal control

We support the separation between "understanding each of the components" of internal control in paragraph 25 from "identifying controls relevant to the audit and evaluating the design and implementation of those relevant controls" in paragraph 26. This separation addresses a key concern with the extant standard that when some auditors use their professional judgment to decide that there are no controls relevant to their audit, they do not understand any of the components of internal control.

However, we believe the reference to "evaluation" within the auditor's understanding of certain of the components of internal control (paragraphs 28 and 31) is not clear and could be confused with the auditor's "evaluation of the design of relevant controls". For example, application material in paragraph A100 and A104 suggests the first three components are considered indirect components and that the auditor would typically not identify controls relevant to the audit from those components. However, paragraphs 28 and 31 require an evaluation based on whether there are control deficiencies identified. Paragraphs A111, A121, A218, and A219 all refer to control deficiencies within the first two components of internal control, but we believe the auditor must perform design and implementation procedures to identify a deficiency. If the IAASB's intention was not to require the auditor to perform design and implementation procedures within these components, we suggest another term such as "assess" be used in place of "evaluate".

While we agree that the auditor should assess the appropriateness of these components (an edit suggested in the paragraph above to paragraphs 28(b) and 31(a)), we believe the auditor can conclude that the control environment is inappropriate without having to identify individual controls within these components and evaluating control deficiencies. Therefore, we suggest the IAASB consider replacing the references to “control deficiencies” in paragraph 28(b) and 31(b) with “inappropriate foundation for other components of internal control”. The application material in paragraphs A111 and A219 provides useful information on the next steps the auditor may follow if the control environment is found to be inappropriate or if the environment raises doubts about the auditability of the financial statements.

Inconsistent reference to the “formality” of components of internal control

Paragraphs 29 and 32 require the auditor to obtain an understanding of the entity’s risk assessment process and the entity’s process to monitor the system of internal controls, “including the extent to which it is formalized”. Paragraph 31(a) uses a different term “including its formality”. It is unclear how the auditor evaluates “formality”. Without the text “the extent to which” in paragraph 31(a), it could be interpreted as a binary decision of formal or not formal. We suggest updating paragraph 31(a) to refer to “including the extent to which it is formalized” to be consistent with the requirements in paragraphs 29 and 32.

Lack of clarity on the type of risk resulting from an entity’s inappropriate risk assessment process

When the control environment is found to be ineffective, paragraph A111 guides the auditor to say this could lead to a financial statement level risk. We believe there should be a similar statement in the application material relating to the entity’s risk assessment process (in paragraph A121) that the lack of an appropriate risk assessment process may lead to a financial statement level risk.

Reference to significant classes of transactions, account balances and disclosures in paragraph 35(a) is circular

Many participants of the field testing were confused by paragraph 35(a) and did not realize that it is intended to assist the auditor in making an “educated guess” or a preliminary assessment of inherent risk based on a reasonable possibility of material misstatement. After discussing the graphic included on page 20 of the explanatory memorandum which references a “preliminary assessment of inherent risk” and making an “educated guess”, and paragraph A141 which contains useful information to explain the linkage between paragraphs 23, 35 and 46, practitioners supported this “educated guess” concept and agreed that the concept is used in practice today. However, this concept was not clear in paragraph 35(a).

Paragraph 23 refers to “understanding the classes of transactions, account balances, and disclosures to be expected in the financial statements.”. We suggest the IAASB consider using language in paragraph 23 that is similar to the lead in to paragraph 35(a) (suggested edits showing in underline and strikethrough):

“The auditor shall obtain an understanding of the information system relevant to financial reporting, including the related business processes, through understanding how information related to ~~significant~~ classes of transactions, account balance, and disclosures that are expected to be significant to the financial statements flow through...”.

***Q5(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?***

While we believe the requirements related to the auditor’s identification of controls relevant to the audit are improved, it’s clear that practitioners have very different interpretations of paragraph 39(e). Results of field testing indicated:

- i. Some practitioners said they would identify a lot of controls relevant to the audit under the requirement in paragraph 39(e) that asks the auditor to identify controls that, in the auditor’s professional judgment, would enable the auditor to identify and assess risks of material misstatement at the assertion level. The inclusion of paragraph 39(e)(i) led them to believe all “in scope” or “significant” financial statement line items would have controls relevant to the audit identified under this requirement.
- ii. On the other hand, other practitioners said they would not necessarily identify any controls relevant to the audit under paragraph 39(e), as they interpreted it as allowing them to use professional judgment in deciding when controls other than the situations addressed by paragraph 39(a)-(d) would be relevant to the audit.

These two interpretations would result in a significant inconsistency in practice. We suggest the IAASB clarify whether the former or latter interpretation (or another expectation) is intended.

We believe the interpretation in (ii) above is correct. If so, an example that could be added in the application material as another bullet in paragraph A179 is to consider whether the auditor would design a different response to the risk if there were controls in place to mitigate the risk. If so, then controls should be identified as relevant to the audit under paragraph 39(e). An example of when the auditor would not design a different response (and therefore would not have identified any controls under paragraph 39(e)) would be if the auditor intended to obtain audit evidence from events occurring up to the date of the auditor’s report to respond to the risk of material misstatement at the assertion level relating to an accounting estimate.

**Q5(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?**

In part. We support many of the enhancements made including to elevate definitions from the glossary and update them in respect of application controls, general IT controls and the IT environment.

However, we believe further improvement is needed in the proposed approach to the information system and communication component.

Lack of clarity in the understanding and evaluation of the information system and communication component

Results of the field testing indicated the requirements in paragraphs 35 and 36, and their relationship with other requirements in the proposals, are not clear. In particular, practitioners were concerned with:

- The depth of understanding required to comply with paragraphs 35(a)-(d) may drive onerous documentation of the business processes related to the information system relevant to financial reporting. For example, the extent of the understanding of the entity’s IT environment considering the broad definition in paragraph 16(g) that includes applications, infrastructure, processes and personnel.
- The types of controls the auditor is expected to identify and evaluate to comply with paragraph 35(a) and paragraph 36. Of particular concern was the reference in paragraph A157 indicating that “controls over the information system are treated as controls in the control activities component”. Some practitioners understood this reference as implicitly requiring an understanding of control activities for significant classes of transactions, account balances and disclosures. Therefore, it wasn’t clear how the requirement in paragraph 36 is different or how it relates to the requirement in paragraph 42 to evaluate design and determine implementation of controls relevant to the audit.

We include the following three recommendations which we believe would bring clarity to the issues discussed above:

- i. We believe this component of internal control should be a higher-level understanding of the business processes and how information and data flows through the entity. We suggest that general IT controls, and all controls related to initiation, recording, processing and reporting transactions should be considered in

the control activities component. By doing so, the requirement in paragraph 35 could be set at a higher level and focus on how the entity obtains or generates relevant quality information, such as data accuracy in reporting and business policies to address data accuracy and the flow of information. The IAASB may consider the terms used in the COSO framework to describe “information and communication” as this is a widely accepted framework.

- ii. We believe this component should also include a consideration of whether it provides an appropriate foundation for the audit or whether there is a pervasive impact on the audit in situations where the methods and controls used in generating this information are weak. An example may be when the entity has no documentation about how transactions flow through the system. In this case, the auditor may need to directly test all information used as audit evidence that is generated by the entity’s system instead of testing operating effectiveness of controls around the generation of that information.
- iii. Clarification is also needed regarding how understanding the IT processes, the IT support structure and the IT applications (in paragraph 35(d)) helps the auditor identify or assess risks of material misstatement. Paragraph A180 seems to indicate the purpose is to obtain a high-level understanding of the IT environment to help the auditor identify whether there are IT applications relevant to the audit. If that is the case, the requirement in 35(d) should be moved and incorporated into the requirement in paragraph 40.

**Q6) *Will the proposed enhanced framework for the identification and assessment of the risks of material misstatement result in a more robust risk assessment? Specifically:***

We support that ED-315 provides a framework for a more robust risk assessment. However, we believe there are areas that could be improved or clarified as follows.

**Q6(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’?***

Yes, we support the requirements to separately assess inherent and control risk. Some practitioners were already separately assessing inherent and control risk under extant 315.

Specifically relating to control risk, we support the language used in ED-315 of “control risk less than maximum” as we interpret this as allowing practitioners flexibility in their respective methodologies to either rely on controls or use more than one category of control risk that is less than maximum.

**Q6(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?**

In part. We support the concept of the inherent risk factors and agree that they assist in identifying risks of material misstatement and assessing inherent risk. Two areas where we believe clarification is needed are as follows:

Lack of clarity on how the auditor determines the appropriate list of inherent risk factors against which to identify and assess risks

The definition of inherent risk factors lists five specific factors for the auditor to consider. However, paragraph A6 lists four other factors as “other inherent risk factors that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure”. The wording used in the introduction to paragraph A6 matches the wording used in the definition of inherent risk factors. Therefore, we believe the auditor is expected to consider the factors in paragraph A6 when assessing inherent risk. The results of the field testing indicated it wasn’t clear that the auditor should consider the factors in paragraph A6. Some participants ignored those factors and believed they only needed to consider the five factors specifically listed in the definition of inherent risk factors.

We are also concerned that the reference to “quantitative significance” and “volume of activity” may give the incorrect impression that larger or more ‘active’ accounts are more susceptible to misstatement. Capital assets are often the largest amount in the financial statements, and operating expenses the accounts with most activities. However, those areas are not the where the risk of misstatement lies in most entities.

We note that paragraph 10 in ISA 570 requires the auditor to consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern when performing risk assessment procedures. Some of the examples included in paragraph A3 in ISA 570 may also be viewed as “inherent risk factors”, impacting risk at the assertion level. For example, “significant deterioration in the value of assets used to generate cash flow” may indicate a risk of impairment of the asset. We encourage the IAASB to clarify the relationship between these concepts.

“Susceptibility to misstatement due to management bias or fraud” not needed as an inherent risk factor

We question whether “susceptibility to misstatement due to management bias or fraud” should be included as one of the factors. We agree with the definition of inherent risk factors - that the auditor would consider the characteristics of events or conditions that

affect the susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure. However, we do not believe fraud is a “characteristic of an event or condition”; fraud is more a symptom of other characteristics such as subjectivity. Once the auditor identifies an inherent risk, they are already required to identify and assess whether those risks were susceptible to fraud and whether it would lead to a fraud risk under the requirement in paragraph 26 of ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*.

We believe fraud should be kept separate under ISA 240, and the inherent risk factor “susceptibility to management bias or fraud” should be removed from ISA 315. If the IAASB believes this inherent risk factor should remain in ISA 315, we ask that the Board clarify its relationship with the requirement in ISA 240.26 to identify and assess the risks of material misstatement due to fraud at the financial statement and assertion levels.

**Q6(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?***

Yes. We support the introduction of a spectrum of risk. Stakeholders said it aligned with how they were applying the concept of risk in practice under extant 315 and the material in ED-315 made the concept explicit. The spectrum of risk is an improvement over the distinction of significant risk vs. not significant. This is a step towards improving audit quality.

However, we believe the “spectrum of risks” as currently articulated in the proposals could result in inconsistencies in practice, especially close to the lower end of the spectrum. Some practitioners interpreted the proposals in a way that as soon as the threshold of a remote likelihood of material misstatement was crossed (i.e., there was a relevant assertion), the “starting point” would be an inherent risk that is low or lower. The inherent risk factors and the combination of likelihood and magnitude would then help the auditor determine if the risk should move up on the spectrum. Other practitioners interpreted that a relevant assertion would equate to a “starting point” of medium or moderate inherent risk. We recommend the IAASB provide guidance for auditors to relate the concept that is in the definition of relevant assertion of “reasonable possibility of occurrence of a misstatement” with the spectrum of inherent risk.

**Q6(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?***

Yes, we support the introduction of significant classes of transactions, account balances and disclosures, and their relevant assertions. These concepts make the scope of this standard clearer for auditors.

During field testing, some practitioners debated whether sales tax would be a significant class of transaction, account balance or disclosure. The sales tax is an account that usually has voluminous transactions, but the year-end balance is normally relatively small. Most participants believe that such an account is usually not significant. However, other participants viewed the example in paragraph A213 as indicating that the auditor should consider all the debits and credits through an account when determining whether it is a significant class of transaction, account balance or disclosure and that an account such as sales tax might be significant because the account contains voluminous transactions. Stakeholders would like further guidance as to when accounts with a low balance at period end may nevertheless be significant.

***Q6(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?***

In part. We support the change to the definition to include the consideration of inherent risk factors and the degree to which they affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should the misstatement occur. This focus on the nature of the risk is an improvement over the extant definition which focused on the response to the risk.

However, we are challenged with the reference in the definition of significant risk to high magnitude of potential misstatement OR high likelihood of misstatement. All stakeholders agreed that risks with high magnitude of potential misstatement AND high likelihood of misstatement should be significant risks. There was concern with using OR in the definition (paragraph 16k) without accompanying application material, as some would interpret the situation of high magnitude but low likelihood as always being a significant risk, and some would interpret it as a rare circumstance. This would result in an inconsistency in practice.

Also, an unintended consequence may be an increase in the number of significant risks that auditors identify in their audits, resulting in inappropriate attention being directed to risks that have a low likelihood of occurring versus other risks. An example of a typically large account balance with a low likelihood of misstatement is existence of property, plant

and equipment. We believe in most cases the auditor would not need to direct significant audit effort to the risk in this assertion. Also, there are other possible impacts on the auditor's work effort and reporting when a significant risk is identified, for example because controls must be tested in the current period when the auditor plans to rely on controls over that risk<sup>1</sup>, reporting key audit matters<sup>2</sup>, among others. We would not expect an item that was previously considered low or normal risk to be identified as a key audit matter simply because the text in ED-315 refers to magnitude OR likelihood.

We acknowledge there could be circumstances when, in the auditor's professional judgment, there is a significant risk that has high magnitude but low likelihood. However, we are of the view that it should be explicitly stated in the application material that such circumstances are expected to be the exception rather than the norm. More guidance should be provided to assist auditors in determining when such risks require additional work effort.

**Q7) *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?***

Yes, we support the additional guidance in relation to the auditor's assessment of risks of material misstatement at the financial statement level. The guidance assists auditors in appropriately determining how risks at the assertion level may be affected by the assessment of risks at the financial statement level.

We suggest that the flowchart entitled "ISA 315 (Revised) Identifying and Assessing the Risks of Material Misstatement" be amended to include a solid line instead of a dotted line between the identification of risks of material misstatement at the financial statement level (paragraph 45(a)) and the assessment of inherent risk (paragraph 48). This is because paragraph 48(b) requires the auditor to take into account how the risks of material misstatement at the financial statement level affect the assessment of inherent risk at the assertion level.

**Q8) *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?***

We believe the stand-back requirement should be retained in ISA 315 and removed from ISA 330. Removing the requirement in paragraph 18 of ISA 330 would reduce confusion

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<sup>1</sup> ISA 330, *The Auditor's Responses to Assessed Risks*, paragraph 15

<sup>2</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, paragraph 9(a).

and enhance clarity as there are different interpretations of why that requirement exists and how it is put into practice. Our field testing indicated:

- i. Some stakeholders interpret ISA 330.18 to require substantive procedures that are more perfunctory in nature or compliance based. The procedures performed by these auditors are not directed toward a particular risk of material misstatement as the auditor has already concluded (in complying with ISA 315) that there was no relevant assertion associated with that account.
- ii. Others interpret the procedures required to comply with ISA 330.18 to be directed at confirming whether the risk assessment performed in accordance with ISA 315 was appropriate.

Now that ED-315 will promote a more robust risk assessment, and the auditor is obtaining sufficient appropriate audit evidence as a basis for the identification and assessment of risks of material misstatement, we believe that ISA 315 will drive appropriate responses to risks. Accordingly, we believe that a further stand-back requirement in ISA 330 is redundant.

If the IAASB decides to keep the stand-back requirement in both ISA 315 and ISA 330, see our response to Q10 below.

**Q9) *With respect to the proposed conforming and consequential amendments to:***

**Q9(a) *ISA 200 and ISA 240, are these appropriate to reflect the corresponding changes made in ISA 315 (Revised)?***

Yes, we believe these conforming amendments are appropriate and complete.

**Q9(b) *ISA 330, are these 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?***

Yes, we believe these conforming amendments are appropriate and complete, with the exception of ISA 330.18 which is discussed in Q8 above and Q10 below.

**Q9(c) *The other ISAs as presented in Appendix 2, are these appropriate and complete?***

Yes, we believe the list of other ISAs requiring conforming amendments is appropriate and complete. However, we believe that it is important that there be an avenue for stakeholders to raise comments on these conforming amendments once they are drafted. Further, if there are items that stakeholders believe are incorrect or need clarification, it is important that the IAASB has a process in place to make changes to these conforming amendments before they are finalized.

**Q9(d) ISA 540 (Revised) and related conforming amendments (as presented in the Supplement to this exposure draft), are these appropriate and complete?**

Our process for dealing with these conforming amendments is not complete because of our need to translate the final ISA 540 materials and seek comment from stakeholders on the subsequent conforming and consequential amendments. We believe that this will also be an issue in other jurisdictions that have not yet translated ISA 540. We will consult with our stakeholders on these proposed amendments when they have a copy of the revised Canadian equivalent to ISA 540 to consider (expected in February 2019). We will bring any issues identified forward to the IAASB before the conforming amendments are finalized.

In the meantime, we have identified one item to note:

- *Paragraph A39* – There is a sentence added to this application material that seems inconsistent with ED-315 as it discusses evaluating design and determining implementation of controls related to higher assessed risks, which is not required by ED-315. The sentence in paragraph A39 reads “The auditor’s evaluation of the design of such controls and determination of whether such controls have been implemented contributes to the audit evidence related to higher assessed risks.” The IAASB may consider rephrasing this sentence so that it doesn’t read like evaluating design and determining implementation of controls is required for risks assessed as “higher”.

**Q10) 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?**

No. As discussed in response to Q8 above, we do not believe the requirement in ISA 330.18 is needed now that ED-315 promotes a more robust risk assessment.

However, should the IAASB choose to keep the requirement in ISA 330.18, we suggest more application material is needed on how to perform the stand-back assessment based on qualitative aspects. We believe that qualitatively material amounts are already dealt with properly under ISA 315 when there is an aspect of risk associated with them. Specifically, disclosures that are considered to be qualitatively material would be considered when identifying significant classes of transactions, account balances, and disclosures under the requirements in ISA 315. The ISA 315 Task Force Chair provided some examples in the IAASB’s October 3, 2018 webinar, such as a related party transaction that is qualitatively material. These examples could be considered as an additional application material paragraph.

***Q11(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.***

The terms “significant” and “material” have very different meaning in the context of risk assessment. We noted that the difference can easily get lost in translation. For example, the term “significant” is typically translated as “*importantes*” in French, while the term “material” is translated as “*significatifs*”. The difference between “*importantes*” and “*significatifs*” is not always easy to determine, as in French the qualitative aspect of one versus the other is not as evident. When the term “significant” is used in ISAs, including in the concept of “significant classes of transactions account balances or disclosures”, we recommend that the context be sufficiently clear to reduce the risk of confusion when reading it in other languages such as French.

***Q11(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.***

We support 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.

## **Other comments on specific paragraphs or matters of interest**

In reviewing ED-315, we have identified a few examples of situations we believe require new application material or non-authoritative guidance in order to promote a more consistent and robust process to identify and assess the risks of material misstatement.

### New application material:

- *Controls over journal entries (paragraph 39(c) and A174-A175)* – to explain how the work effort in this requirement relates to the risk of management override addressed in ISA 240, and the required testing of journal entries in paragraph 20 of ISA 330.
- *Substantive procedures alone not ~~sufficient~~ (paragraph 51)* – Two situations where additional application material is needed include:
  - more modern examples of when the auditor may find themselves in this situation (e.g., without mentioning specific companies, describing a business model such as Uber that has no physical assets and all transactions are completed on-line), and
  - what does the auditor do if they find themselves in a situation where controls are not operating effectively? Paragraph A239 points the auditor to testing controls, but if controls are determined to be not effective, should the auditor express a modified opinion? We believe the application material should address the next step.
- *The concept of aggregation risk considered in the assessment of significant risk (around A229-A230)* – to explain the auditor should consider whether a significant risk exists when there are several related risks or risks in a similar process which are higher on the spectrum of risk but not individually high enough to be considered a significant risk. For instance, does the aggregate of those higher risks suggest the presence of a significant risk?

### New non-authoritative guidance:

An example of where we believe new non-authoritative guidance is needed at the same time ISA 315 is effective is in applying the new concepts in ED-315 to group audits, especially for all the information surrounding the IT environment.