



**The Institute of
Chartered Accountants
of Pakistan**

**CA
PAKISTAN**

HEAD OFFICE

November 02, 2018

(Submitted electronically)

Technical Director
International Auditing and Assurance Standards Board (IAASB)
529, Fifth Avenue, 6th Floor
New York, USA

COMMENTS ON EXPOSURE DRAFT - ISA 315 (REVISED) 'IDENTIFYING AND ASSESSING THE RISK OF MATERIAL MISSTATEMENT'

The Institute of Chartered Accountants of Pakistan (ICAP) is pleased to comment on the Exposure Draft on ISA 315 (Revised) '*Identifying and Assessing the Risk of Material Misstatement and Proposed Consequential and Conforming Amendments to Other ISAs*' (the Exposure draft), published by the International Auditing and Assurance Standards Board (IAASB) in July, 2018.

Our detailed responses to the questions contained in the Exposure Draft, are presented in the appendix to this letter.

We hope that our comments are helpful to the IAASB's deliberation on the Exposure Draft.

Should you require further clarification on our comments, please contact the undersigned, sohail.malik@icap.org.pk

Yours truly,

Sohail Malik
Director Technical Services

Enclosed: Appendix

(Established under the Chartered Accountants Ordinance, 1961 - X of 1961)

Comments on IAASB Exposure Draft on ISA 315, 'Identifying and Assessing the Risk of Material Misstatement and Proposed Consequential and confirming amendments to Other ISAs'

Overall Questions

Question 01

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?

We acknowledge that the proposed revisions in ISA 315 will help in improved understanding of risk assessment, leading to a more robust and comprehensive risk assessment process.

We note that the inclusion of introductory paragraphs, which provide summary of flow of auditor's risk assessment process and the overall structure of the standard, are helpful in reading and increasing the understandability of the standard. Similarly, the flowcharts are also helpful and we note that these should be included in the final standard. However, to avoid confusion it would be useful to describe the status of introductory paragraphs (i.e. are they authoritative?). Further, we would like to highlight that the flowcharts could be further enhanced to more clearly explain what is inherently an iterative process in a more imaginable and understandable manner.

We also agree that the proposed revisions will promote more robust process for the identification and assessment of the risks of material misstatement. The proposed revisions address specific challenges and issues like understanding entity's system of internal control, IT related risks arising from use of automated tool and techniques, determining audit, inherent, control and significant risks and related risk of fraud and introduction of new definitions and concepts and its linkage with ISA 200, ISA 540 (revised) and ISA 330. We also agree that any public interest issues are well addressed.

Question 02

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?

We agree with the IAASB approach of scalability of the risk assessment requirements to varying nature and sizes of entities and circumstances. The application material is sufficiently scalable and can be applied to the audit of entities with a wide range of sizes, complexities and circumstances.

However, we note that the length of the proposed revised standard could be a barrier to its application to audit of less complex entities. We understand that IFAC has issued an Audit Guide for audit of SMEs, and more guidance and examples on how to effectively scale the work effort to less complex entities may be included in the revised standard for improved understanding and scalability.

Comments on IAASB Exposure Draft on ISA 315, 'Identifying and Assessing the Risk of Material Misstatement and Proposed Consequential and confirming amendments to Other ISAs'

Question 03

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?

In general, we are supportive of the IAASB consideration of the technological environment in the revised standard. Therefore, we agree that discussion on the matter through application material (Appendix 1) and observe that the examples are very relevant for auditor's risk assessment process.

However, we understand that further guidance (definition, scope etc.) on automated tools and techniques including data analytics should be given in the revised standard for reader's understanding. This is also necessary owing to the fact that data analytics is an emerging concept and its use is not common in most of the underdeveloped countries, especially on less sophisticated audit clients. Therefore, the practicability aspect of the use of automated tools and techniques and data analytics requires further consideration.

Question 04

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 acknowledge that the revised standard reinforces the exercise of professional skepticism throughout the risk assessment and identification process. This reinforcement is expected to further encourage auditors to follow the principle of professional skepticism.

We are supportive of the principle of obtaining an appropriate base of evidence for risk assessment. However, we note that the term "sufficient appropriate audit evidence" (used in paragraph 17 of ED 315) is associated with drawing conclusions on the evidence collected on the financial statements as a whole and not during the risk identification and assessment phase. We have also noted that using this term in the proposed revised standard is inconsistent with the definition of audit evidence in ISA 200. Accordingly, we believe the IAASB need to consider if paragraph 17 is appropriate, and its impact on ISA 200.

Comments on IAASB Exposure Draft on ISA 315, 'Identifying and Assessing the Risk of Material Misstatement and Proposed Consequential and confirming amendments to Other ISAs'

Specific Questions

Question 05

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 of 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 that the enhancements in ED 315 provide further clarity in relation to what is required when obtaining an understanding of each component of the entity's system of internal control 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?

We also agree that the requirements related to the auditor's identification of controls (contained in paragraphs 39 and A166 and A167) provide clarity on the identification of controls relevant to the audit.

However, we consider that the controls relevant to the audit of smaller and less complex entities may be further elaborated with examples for guidance purposes.

- (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 support the introduction of the new IT-related concepts and significant enhancement (including elevated definitions given in glossary of terms) to the auditor's consideration of IT when obtaining an understanding of entity's internal control. Flowchart 3 also elaborates entity's use of IT for obtaining understanding of information system relevant to financial reporting and communication component.

Comments on IAASB Exposure Draft on ISA 315, 'Identifying and Assessing the Risk of Material Misstatement and Proposed Consequential and confirming amendments to Other ISAs'

Question 06

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?

We support separate assessments of inherent and control risk at the assertion level and revised requirements and guidance are appropriate to support the separate assessments. This concept has already been approved in ISA 540 (revised) and ED 315 extends the requirement in relation to risks of all material misstatement.

- (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?

ED 315 contains a number of proposals in public interest including definitions of 'inherent risk factors'. This concept is already given in ISA 540 (revised) and consistent with the way it is described in ED 315. We agree that the concept of 'inherent risk factors' intends to assist with the identification and assessment of the susceptibility of assertions to misstatement, a link has been made to the auditor's consideration of susceptibility of misstatement due to fraud. Appendix 2 of proposed ISA 315 is also helpful in identifying events and conditions that may indicate susceptibility of risk material misstatement.

- (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?

This concept is already introduced in ISA 540 (revised) and consistent with the way it is described in ED 315. Primarily we agree with the introduction of the term 'spectrum of inherent risk' and its linkage with the inherent risk factors. We understand that is a subjective term and should be further supported /explained with appropriate examples.

- (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 agree and support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and their relevant assertions and the related guidance given in ED 315 and its application material.

Comments on IAASB Exposure Draft on ISA 315, 'Identifying and Assessing the Risk of Material Misstatement and Proposed Consequential and confirming amendments to Other ISAs'

(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 definition of significant risk being aligned to the nature of the risk and the susceptibility to fraud or error, and not the auditor's response to a risk as it is in extant ISA 315.

In relation to the definition of significant risk and the matters presented in paragraph 57 of the IAASB's Explanatory Memorandum, we consider that risks with a 'very low likelihood' but 'high magnitude' should not be automatically significant risks, and therefore the definition should be changed so auditors consider likelihood and magnitude in combination when determining significant risk.

Question 07

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 recognize that that the additional guidance in relation to financial statement level risks explains how these are assessed at the assertion level. However, we consider that auditors' in general find this difficult in practice and more guidance or examples could be provided. Further, example/s of risk of material misstatement at the financial statement level and how this may affect the assessment of risks at the assertion level should be provided in the appendix to the revised standard.

Question 08

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 support the proposed stand-back requirement as this approach will result will promote professional skepticism and professional judgment, which are imperative in risk assessment. We also believe that the requirements of both the paragraphs i.e. paragraph 52 of ED-315 and paragraph 18 of ISA 330 are interlinked and support each other and both should be retained.

Comments on IAASB Exposure Draft on ISA 315, 'Identifying and Assessing the Risk of Material Misstatement and Proposed Consequential and confirming amendments to Other ISAs'

Conforming and Consequential Amendments

Question 09

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)?

Please refer to answer to question 04, above.

- 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?

Yes, we agree.

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

Yes, we understand that these are complete.

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

We agree with the appropriateness and completeness of supplement on ISA 540 to this exposure draft.

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?

We understand that both these paragraphs serve a similar purpose to safeguard against imperfect risk identification and assessment. Therefore, we support the proposed revisions to paragraph 18 of ISA 330 and its alignment with the scope of the proposed stand-back in ED-315.

Comments on IAASB Exposure Draft on ISA 315, 'Identifying and Assessing the Risk of Material Misstatement and Proposed Consequential and confirming amendments to Other ISAs'

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.

No comments.

- 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 consider the effective date to be appropriate.