



10 November 2018.

Re: Comments on ED-315: Identifying and Assessing the Risks of Material Misstatement.

We wish to recognise the efforts of the IAASB Board and the Task Force, and the team at IAASB for improving global auditing practices. We assure you of our staunch support in this mission.

We are a firm of chartered accountants engaged in public practice registered with the Institute of Chartered Accountants of Pakistan. We aim higher to achieve a character and technical competence .

We are pleased to submit our comments on the ED-315.

A summary of our recommendations is as follows-

1. Refer to the 'risks of material misstatement' at two levels properly at each instance. Refer to it as either as 'material misstatement at the overall financial statement level' or 'material misstatement at the assertion level'¹¹. For the sake of clarity let it mean in all instances 'for classes of transactions, account balances, and disclosures'.
2. Extend the structure to facilitate the auditors of smaller and less complex entities to conform to its requirements. Provide separate guidance for the smaller and less complex entities. Include supplementary exclusive guidance for 'specific consideration for smaller (and less complex) entities' in line with ISA 200. This may be derived from the main text and summarized in one place. Address common concerns directly, like situation with unreliable system of internal control. (Q1a)
3. Keep the language simple. It takes a toll on the user's time and understanding. Pay utmost attention to the form and writing style. Say it simply and clearly. Construct small sentences with a good flow and structure. Edit document to reduce verbosity; purge it from repetitive and superfluous content. This is true for the application and other material. Match sub-headings in italics as in 'application and other explanatory material' for whole paragraphs in the main standard.(Q1)
4. Include revised simplified flow charts in appendices. Make flowcharts understandable. Purge flowcharts of unnecessary text. (Q1a)
5. Retain 'Key concepts in this ISA' as a part of introduction. Provide what ED-315 requires in a single para in five key sentences. Don't miss on mentioning summary requirements for documentation, too. Use same headings as in the contents for key concepts (Q1c).
6. Introduce a Glossary of Terms as an appendix. Include terms such as data analytics. (Q6d)
7. Make commenting on the status of internal control a part of the audit report. (Q5a)
8. Relieve auditor of stand-back arrangements. (Q8)
9. Practices differ on scales used for measuring / rating of internal control by auditors. An auditor is free to use any of these or their own scale for this purpose. Clarify! (Q2)
10. Separate assessment of inherent risk and control risk at the assertion level is the right approach. (Q6a)
11. Giving consideration to quantitative as well as qualitative aspect of materiality is the right way. (Q10)
12. Pay special attention in developing guidance on documentation requirements. This is the weakest link in the training of auditors of SMPs. Encourage member organisations to be more responsible. (Q2)

¹¹ As in paragraph 17: 'risks of material misstatement at the financial statement and assertion level'. The first four words were sufficient to convey the purpose. The term used properly in paragraphs 19 and 30.



Overall Questions

General Comments

Q1. Has ED-315 been appropriately structured, clarified and modernized in order to promote a more consistent and robust process for the identification and assessment of the risk of material misstatement. In particular:

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)?

Q1(b) Will the revisions promote a more robust process for the identification and assessment of the risk of material misstatement and do they properly address the public interest issues outlined in paragraphs 6-28?

Q1(c) Are the new introductory paragraphs helpful?

A1. Yes. We appreciate the effort gone in its 18-month development lifespan. We call upon to direct your attention in the final phase in coming up with a user-friendly document in terms of structure and form.

Our response to each attribute follows:

1. Structure. "ISA-315 sets out the risk assessment procedures that form the foundation of an audit of financial statements"². We would like to see its structure to respond directly to the varied needs of auditors - a practitioner who is looking for specific guidance for a micro entity; or the one looking for guidance for a small and medium sized entity. Think of an auditor of public sector entities who would like to see all relevant guidance in a single place. Why auditor have to go through the full text before picking what is relevant? The structure is one-size-fits-all. We respectfully reject this approach. We have carefully considered embedding of guidance for smaller and less complex entities in the text but do not agree to such presentation. We are open that size may not necessarily relate to the complexity³. The level of complexity is statistically strongly correlated to the size of entity, our experience suggests⁴; outliers do not deserve such attention.
2. Clarification. The standard of writing of a document of such importance needs to be high on readability. We believe that the size of "Application and Other Explanatory Material" can be reduced by a third with a better style and without loss of understanding. Achieve clarity of contents with good diction. List all sub-headings for 'Application...' in one place. Harmonise 'Contents'⁵.
3. Modernised. The focus on IT related topics as a component of internal control is useful. Room for the latest technologies is also there.

A1(a): No. Re-structure ED-315 to make it easier for the auditor to get down to what is relevant to one's interest at the earliest. Consolidate guidance for smaller entities separately in one place. Similarly, consolidate guidance for auditors of public-sector entities in one place.

² Explanatory Memorandum to ED-315(Revised). Executive Summary. 3rd para.

³ Para 13: "While the size of an entity may be an indicator its complexity, some smaller entities may be complex and some larger entities may be less complex".

⁴ Sorry for not quoting any authentic study here to support our experience.

⁵ The six entries listed in 'Contents' under 'Requirements' and 'Application...' are identical. One additional entry in 'Application..' missing in 'Requirements' is: 'Understanding the components of the entity's internal control'. This is so because heading over para 27 should be the same, and listed in 'Requirements' too. These two link with Appendix 3.



Simplify and redraw flowcharts, there is too much text there; include simplified flow-charts as an appendix.

The feature of cross-referencing of contents makes the document understandable. Thanks! Even better, if the soft copy contains electronic link to access the referenced content instantly, and make it back to the point to proceed further.

ED-315 is not a stand-alone documents. References to other ISA makes its overall understanding challenging.

A1(b): Yes. We applaud the effort of the Board and the Task Force in making it so.

A1(c): Yes. They are helpful. We also appreciate 'Key concepts in this ISA' which provides a brief and concise high-level summary that warms up users. Match each heading listed under the 'Requirements' in the contents as a sub-heading in the 'Key Ideas...'. This will ensure completeness; and the revised version will surely include a summary of requirements relating to the documentation as well.

Is it possible to come up with all the requirements of this ISA summed up in one para? "This ISA requires that- (1),(2)...(3)..." A kind of a master/crown paragraph.

Match the sub-headings in italics in 'Application and other explanatory material' to main para in the standard.

Applicability on a variety of audits having different characteristics

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?

A2: No.

We do not find the requirements and application of ED-315 to be sufficiently scalable. In reality, a standard is for stakeholders with varied needs; in its present form and structure, it poses learning difficulties for those of my colleagues specially whose native tongue is not English.

That the SMPs are the weakest link in the chain of compliance is a fact. Most practitioners find it difficult to catch up with the rapid changes and feel intimidated over compliance of the ISAs. Documentation is a weak area ripe for any training and interaction. This gets acute specially when no corresponding effort is undertaken by IFAC members to address such issues.

We fully support the role of IAASB as the standard-setter. However, we miss a representative voice in the IAASB vocal enough to raise the issue of making compliance with the standards in the non-native English countries a priority of the IAASB.

To conclude, we openly invite the Board to take up the discussion on how to strengthen compliance by non native English countries and SMP there through a technology learning platform. We also invite our dear Institute to constantly arrange ISA trainings and interactions with practitioners, starting with the documentation aspect.

Automated tools

Q3. Do you agree with the approach taken to enhancing ED-315 in relation to the automated tools and techniques, including data analytics? Are there other areas in ED-315 where further guidance is needed and what is the nature of the necessary guidance?

A3: Yes.



Nature of further guidance. The data analytics may also involve further splitting of the underlying data into sub-categories, for further understanding and valid conclusions about account balances, class of transactions and disclosures. 'Audit Schedules' are prepared by auditors or by the client on direction of the auditors for further analysis or validating conclusions. As audit evidence these schedules become a part of working papers. Data is transformed into information, often not available readily on information systems. Such audit scheduling by auditors is one technique used by auditors to learn about the composition of data which may in turn point to the risks. Is there a need to recognise such practice as helpful in the process of identifying risk?

Professional skepticism

Q4. Do the proposals sufficiently support the 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'? Do you believe this clarification will further encourage professional skepticism?

A4: Yes. We support exercise of professional skepticism throughout the audit and obtaining sufficient appropriate audit evidence. We welcome the clarification on professional skepticism.

Specific comment:

Entity's System of Internal Control

Q5. Do the proposals made relating to the auditor's understanding of the entity's system of internal control assist with the 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:

Q5(a) Have the requirements related to the auditor's understanding of each component of the entity's system of internal control been approximately enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?

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 small and less complex entities?

Q5(c) Do you support the introduction of new IT-related concepts and definitions? Are these sufficient to support identification and assessment of risks of material misstatement?

A5: No.

Management of the entities are free to have the kind of internal control system suitable to their needs. They may decide even not to have one. Why? There is no obligation on anybody to have one. In my part of the world, and perhaps others, management are more conscious about the cost than the intangible unidentified immeasurable benefit of having a suitable system of internal control, most have none and are not even conscious about it. Audit, for most, is just a formality. They know auditor is bound to an opinion on the financial statements. Why bother about a term that is not even mentioned in the entire audit report?

A system of internal control is central to the conduct of an audit. If true, make it a point of audit report. We wish there was a provision in the audit report about the most important matter which significantly affects the work of



an auditor: internal control. “During the course of audit, we have reviewed the system of internal control and have rated its overall effectiveness as Satisfactory/Good/Fair/Non-existent and/or unreliable. We have/have not noted any improvements from the last audit. A system of internal control is.....” Is there any other way of making management more sensitive about it?

Small and medium sized practices mostly serve smaller entities and face the reality of owner-manager or dominant individual⁶ everyday in most audits. If a client do not have a system of internal control because they are not sophisticated enough to understand its importance or for any other reason, what can an auditor do? Its not the same to do go through every transaction, even that will not suffice.

It is global that our clients face difficult operating and business environment which compels them to keep the costs at minimum and enhance productivity. One or two-person accounting department or totally outsourced accounting services are facts; these same forces mirror in public practices which suffer from anemic audit fee growth; only single staff is assigned with a stiff deadline to do everything, unlike an audit team in the past. So what kind of internal control can one expect? Technology is live and kicking threatening to wipe out the position of full-time accountants. In short, cost pressures do not permit the clients to improve system of internal control. On the other hand, auditors do not have yardsticks to measure the same or the means to report on them.

One way of making the ED-315 more relevant is to provide more guidance on what needs to be done on the first and recurring audits⁷. This is as important as it is for complex and not-so-complex entities.

The standard setters understand that the requirements for the complex audits may not be relevant to the not-so-complex entities. If true, why not we reflect it in ED-315? The practitioners are on a lookout for relevant exclusive guidance. An area of overlap is understandable but not the present regime of having buffet-standards audit mindset. I give credit to International Accounting Standards Board for liberating itself from those shackles and coming up with a stand-alone version of IFRS for SMEs.

We do wish ISAs to split metaphorically on the same pattern with size and complexity reigning. We see it as two lanes of the same road. It helps to have proper signage to be guided to the destination!

To conclude, the proposals here do not assist with understanding the nature and extent of the work effort required; the ISAs contain statement of principles than prescription. Most smaller entities do not have proper system of internal control because of cost/benefit, technology and economic compulsions. Times are changing and auditors of smaller entities will find it even difficult to give a fair opinion based solely on substantive testing.

A5(a) No. We are not sure how auditor would conclude the understanding of the matters mentioned in para 27. It lacks guidance on what to do if the internal control system is not there. It calls to ‘demonstrate’⁸ a term that we find to be quite subjective. Appendix 1 helps but leaves one without much confidence.

A5(b): There are two separate questions:

⁶ See para 113. “Some entities may be dominated by a single individual....”. The text in last two sentences may be revised to state: “For example, direct involvement by this individual may contribute significantly in enhancing internal control system of the entity; it may also lead to an increased susceptibility to misstatements through management override of controls because of concentration of authority.”

⁷ More in line with paras 20 and 21.

⁸ We found the example stated in para A108 for demonstrating the commitment to the integrity and ethical values of the entity to be amusing.



Yes, the auditor's identification of controls relevant to the audit have been appropriately enhanced but do not appear to be appropriately clarified.

No, the guidance for audits of smaller and less complex entities is not clear. Most small and medium size entities do not have adequate internal controls. They are short in every component of the internal control.

A5(c) Yes. We fully support the introduction of IT related concepts and definitions. However, much of the discussion is not relevant for the smaller and less complex entities. Consideration specific to use of third-party software on cloud is not addressed.

Q6. Will the proposed changes result in a more robust risk assessment? Specifically:

Q6(a) Do you support separate assessments of inherent and control risk at the assertion level; are the revised requirements and guidance appropriate to carry out such assessments? (Q paraphrased for clarity)

Q6(b) Do you support the concepts and definitions of 'inherent risk factors' to help identify risks of material misstatements and assess inherent risk? Is there sufficient guidance to explain how these risk factors are used in the auditor's risk assessment process?

Q6(c) In your view, will the introduction of the 'spectrum of inherent risk' assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks?

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 occurrences 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?

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?

A6. Yes. We support separate assessment of inherent and control risk at the assertion level.

Yes, revised requirements to carry out separate assessments of inherent and control risk are appropriate.

No. Improve the form of guidance for assessment of inherent and control risk assessment.

A6(a) Yes.

A6(b) Yes.

A6(c) Yes.

A6(d) Yes.

Many terms in the IAS (such as data analytics) have been defined in the running text. Conveying their meaning and explaining terms defined elsewhere such as audit risk as a glossary of key terms may be helpful for the users. Also, an 'Index' with key entries and paragraph references with electronic links to access relevant paragraph instantly may help navigate a long document. For example, there is no reference of para 54 (documentation) in para 22(audit team engagement discussion). They will appear together in an index.

A6(e) Yes.



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 of how, and the degree to which, such risks may affect the assessment of risk at the assertion level?

A7: Yes.

Q8: What are your views on the proposed stand-back requirements in the ED-315 and the revisions made in the paragraph 18 of ISA 330 and its supporting application material? Should either or both requirements be retained? Why or why not?

A8. We are not in favour of retaining both the requirements at once.

We see stand back arrangement as an unnecessary duplication. Any concerns may well be addressed by revising the text. We admit in a lighter vein that the term sounds so good that we are reluctant to oppose it but in substance it adds another layer of requirement.

Conforming and consequential arrangements

Q9. Are the following appropriate and complete:

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

Q9(b) Changes in ISA 330 as a consequence of the introduction of the concept of general IT controls relevant to the audit in ISA-315(Revised).

Q9(c) The other ISAs as presented in Appendix 2

Q9(d) ISA 540 (Revised) and related conforming amendments (see separate supplement)?

A9. We have not reviewed this in detail and are not in a position to make a meaningful comment.

Q10. Do you support the proposed revisions to the 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?

A10: No. We do not favour stand-back in ED-315. Yes, we welcome and embrace elaboration of the term 'material'.

Issues in translation of Standards and effective date

Q11(a) Potential translation issues in reviewing the ED-315.

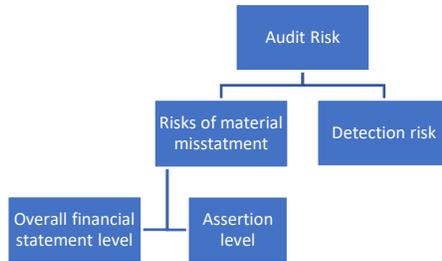
A11. We have already recorded our concerns on the style of writing of this ED-315 which make the task of translators difficult. We have emphasised use of short sentences. Use key words as sub-headings to signal change of topic. We long to see a compressed and concise 'application and other material' through diligent editing; add a glossary containing meaning of key terms and explanations. We hope to see these measures to result in high-quality translations.

Our motivation for simplified well-understood reasonable-length user-oriented standards is inspired by the objective of earning public understanding of what auditors do. Therefore, we recommend to our Institute to initiate communications in local URDU language, starting with a brief overview of this standard.



Additional Comments:

1. Para 2. This may be expressed as:



2. Para 5 first sentence. Revise as: ‘This ISA requires auditors to assess inherent risk and control risk separately for the identified risk at the assertion level’. Sub-heading: ‘*Separate assessment of inherent and control risk at the assertion level*’.
3. Para 5 after first sentence. Assign separate para for auditor assessment of inherent control risk. Sub-heading: ‘*Assessing inherent control risk*’.
4. Para 6: We found it difficult to follow this para. Our understanding is as follows: “In assessing control risk at the assertion level, the auditor may decide to rely* or not to rely** on operational effectiveness of controls that address the identified risks of material misstatements. (*The control risk will be assessed at less than maximum. **The control risk will be assessed at the maximum).” Sub-heading: ‘*Assessing control risk*’.
5. Para 7. This para contains extension of an idea in ISA 200. It omits to mention a situation and in turn impairs user understanding. The risk of material misstatement arises at two levels, at the overall financial statement level and at the assertion level; it is already expressed reasonably well in para 2. Second, the auditor designs and performs further audit procedures for both levels. Design and performance of audit procedures at the overall financial statement level is mandatory, whereas it depends on assessment of control risk at the assertion level. The option available to the auditor is not apparent from the narrative. The auditor may decide not to rely on system of internal control and not to conduct further audit procedures. Revise: ‘The risk of material misstatement may rise from the overall financial statement level and at the assertion level. The auditor will design and perform further audit procedures directed at both levels. However, there may be a situation where no further audit procedures are designed and performed at the assertion level based on auditor assessment of control risk’.
6. Para 8: The risks of material misstatement may include those arising from error and fraud, or both. In addition to this ISA, the ISA240 provides additional requirements and guidance on misstatements due to fraud. This may be expressed in the form of a table:

Risk of aggregate material misstatement	Fraud	Error
- At overall financial statement level	Yes. Also ISA 240	Yes
- At assertion level	Yes	Yes



7. Para 9, last sentence: Revise: 'The auditor's understanding of the system of internal control and its components. including the information system, assists the auditor in refining such expectations throughout the course of audit'.
8. Para 10: Revise: 'The auditor identifies the risks of material misstatement and proceeds to determine the classes of transactions, account balances, and disclosures'. We do not recommend having stand-back.
9. Para 11: Revise: 'The process of risk assessment includes identification of material misstatements at the assertion level for which no level of substantive testing on its own may provide sufficient appropriate audit evidence'.
10. Para 12: Revise: 'This ISA requires auditor to be alert during the course of audit if there is new information available to the auditor that warrants applying professional judgement and revisiting the original risk assessment model. Such information may come auditor's knowledge from verifiable sources such as audit evidence obtained and other sources'.
11. Para 13: Include in this ISA specific considerations for smaller entities in line with ISA 200. We do not support the embedding of these consideration without an identity of its own.
12. Para 15: Very well written.
13. Para 16, first row: Revise: 'The terms used in this ISA are defined to mean as follows-'
14. Para 17. Consider to delete: ~~to obtain sufficient appropriate audit evidence~~. Also, delete the words 'at the financial statement and assertion levels' because the term 'risks of material misstatement' implies both⁹.
15. Paragraphs 20-22 is about audit engagement teams and partners. Use sub-heading. Also, through a footnote link para 22 to para 54 which requires the discussion of engagement team to be documented.
16. Para A114 states: "Overall, although a control environment that provides an appropriate foundation for the system of internal control may help reduce risk of fraud, an appropriate control environment is not necessarily an effective deterrent to fraud". We find the message to be contradictory. Consider to revise it to state: "An effective and functioning control environment may be expected to reduce the risk of fraud of certain nature it may not be expected to be effective against all".

End of Comments.

Thank you.

Sincerely yours

Altaf Noor Ali.

Chartered Accountants.

To: The IAASB. Via uploading at the web-site.

Copy: Honourable President, Institute of Chartered Accountants of Pakistan.

⁹ See point 1 page 1 of our summary of this doc.