

EFAA President, 4 Rue Jacques de Lalaingstraat, 1040 Brussels

International Auditing and Assurance Standards Board
529 5th Avenue
New York, New York 10017
United States of America

Bodo Richardt
President

4 Rue Jacques de Lalaingstraat
B-1040 Brussels
T +32 2 736 88 86
bodo.richardt@efaa.com

Brussels, 23rd November 2018

Dear Sir or Madam,

Response to the Exposure Draft (ED), International Standard on Auditing 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*

The European Federation of Accountants and Auditors for SMEs (“EFAA”) represents accountants and auditors providing professional services primarily to small and medium-sized entities (“SMEs”) both within the European Union and Europe as a whole. Constituents are mainly small practitioners (“SMPs”), including a significant number of sole practitioners. EFAA’s members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, tax and business advice) to SMEs. EFAA represents 16 national accounting, auditing and tax advisor organisations with more than 370 000 individual members.

EFAA is pleased to provide its comments to the IAASB[®] Exposure Draft, ISA 315 (Revised), [Identifying and Assessing the Risks of Material Misstatement](#) (ED-315), which have been prepared with input from our Assurance Expert Group. Below you will find ‘General Observations’ followed by the questions posed in the ED. In many cases, especially the specific and conforming changes ones, we provide little or no comments since we think it better that the Board addresses the bigger issue of scalability first.

GENERAL OBSERVATIONS

Scalability

ISA 315 (Revised) is essentially the bedrock of the risk-based audit making it the single most important ISA. This means it is critical we get it right and that it can be applied in a proportionate manner to audits of smaller and less-complex entities. While we appreciate the efforts taken to improve the extant standard - in particular, to modernize it to reflect developments in technology – and that it will likely improve the audit quality of larger more complex entities, we have reservations about the length and complexity of the standard and, ultimately, whether it is sufficiently scalable for audits of smaller and less-complex entities. While the flowcharts are essential aids to navigating and understanding the standard, they simultaneously demonstrate the ED’s complexity. If the standard were simpler then they may not be required.

We believe the ED-315 will need to be extensively reworked if it is to meet the test of scalability. In the absence of such changes there is a high risk that the standard will erode the effectiveness and efficiency of audits of smaller and less complex entities. Ultimately, this may trigger widespread rejection of the standard by those auditing smaller and less-complex entities and lead to further calls

for different standards for audits of smaller and less complex entities from those for audits of listed companies and other public interest entities (PIEs). Hence, we strongly recommend that the IAASB investigate how it might build further scalability into the standard and, simultaneously, initiate the timely development of implementation support for audits of smaller and less complex entities.

We note the infusion of concepts from the PCAOB's auditing standards. While international harmonisation is generally welcome, we question whether introducing such concepts, designed for large listed entities in an advanced Western economy, lend themselves to a standard used in the audits of SMEs around the world. The PCAOB did not have non-complex, small and scalability in mind when they developed them. We therefore urge caution in adopting such concepts for all audits.

ED-315 is highly sophisticated and we believe likely to encourage auditors of smaller and less-complex entities to box tick the risk assessment and eat up time and resource that does not contribute towards audit quality. It is vital the IAASB simplify the proposals.

Modernising the ISAs

We support the attention given to how new and emerging technologies are impacting the client's systems and controls and, therefore, the need to update and modernise the ISAs to reflect this. ED-315, however, tends to treat IT as a stand-alone issue and describes its impact and application in a highly complex and detailed manner. IT controls are the norm and so need to be seamlessly integrated into the audit and ISAs. Accordingly, we suggest integrating IT controls and simplifying the text.

While we welcome the inclusion of automated tools and techniques in ED-315 we note this is only done in the application material supported by some examples. We suggest the Board affords this more prominence and consider how these tools and techniques can be used to provide sufficient and appropriate audit evidence.

EFAA Survey on Assurance for SMEs

We conducted a survey of SMEs in Europe (though many respondents from the rest of the world also responded to the online open access survey) about their attitudes to audit and assurance in Q2 2018. We are now writing up the report and plan to publish it in Q1 2019. The preliminary results provide some interesting insights worth summarizing here.

One question asked respondents, the majority being owner-managers of family controlled / owned firms, to cite the benefits to the company from having the accounts audited. The top three most commonly cited benefits were 'audit provides a check on accounting systems and records', 'auditor provides useful advice to management' and 'improves internal control' significantly ahead of 'improves the quality of the financial information' and 'gives assurance to external providers of finance'. In other words, the primary benefits to having an audit accrue to internal users, specifically management in the form of expert advice and a check, rather than to external users, such as providers of finance in the form of assurance. This is perhaps not surprising given that most respondents were owner-managers. Notwithstanding this the finding may reflect a difference in the objectives of the audit for SMEs vis-à-vis large quoted enterprises and suggests the need for the profession to better promote the audit by stressing the wide range of benefits with heightened emphasis on the benefits like improvements to internal control and a check on accounting systems and records.

OVERALL QUESTIONS

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:

(a) Do the proposed changes help with the understandability of the risk identification and assessment process? Are the flowcharts helpful in understanding the flow of the standard (i.e., how the requirements interact and how they are iterative in nature)?

We believe that the flowcharts are key to helping auditors understand and navigate the standard. That the use of flowcharts of itself suggests that the standard is excessively complex and insufficiently clear. Flowcharts should not be a substitute for clear text. We also question whether the footnotes to the flowcharts adequately depicts the iterative nature of the risk assessment process.

ED-315 is convoluted and there is much unnecessary duplication for example, paras 19-21 relate to the same subject matter and there are many references to other ISAs and paragraphs that repeat what are in other ISAs. This makes it difficult to navigate ED-315.

(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?

While modernizing the standard to reflect changes in technology and the business environment is crucial, we are concerned that the standard has become overly complex. We fear the requirements and application material are insufficiently principles-based and, in their undermining the cost-effectiveness and efficiency of the audit of smaller and less-complex entities, we believe the revisions fail to address the public interest issues cited.

Understandability will be improved by clearer and more succinct descriptions of the concepts underpinning the requirements and illustrating them by way of figures. We also recommend eliminating duplication and repetition by removing references to other ISAs where possible.

In addition to our general observations above as to suitability for audits of SMEs we see scope for further improvements that will improve scalability. We welcome the requirements of paras 24 and 31(a) for the auditor to ‘evaluate’ whether the entity’s accounting policies are, and the nature of the entity’s risk assessment process is, respectively appropriate to the entity’s individual circumstances as this encourages the exercise of professional judgement, duly taking account of the auditor’s understanding, in the light of the individual circumstances of the entity, including its size and complexity and any other relevant factors. We suggest, however, that ‘evaluate’ be softened by modifying to ‘consider’ and that a similar ‘appropriateness consideration’ be more widely employed beyond these two matters, for example, to the design of controls (para. 26) and control activities (para. 38)). Such a focus on the appropriateness for the specific entity would promote scalability.

(c) Are the new introductory paragraphs helpful?

We believe the new introductory paragraphs are helpful.

While the introductory paragraphs are generally helpful in understanding the standard we are, however, concerned that the references to smaller and less complex entities are unclear. Generally, smaller entities are less complex than larger entities, but this is not always the case.

Simpler, less onerous requirements should apply to entities that are less complex, less risky and by virtue of size of lower public interest.

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?

As we have stressed before multiple data sources prove that SMEs collectively constitute the vast majority organizations by number and the majority of private sector GDP and employment as well as social and environmental impacts. Most SMEs are micro-entities and, as our survey cited above revealed, a significant proportion are owner-managed family-controlled entities, which are straightforward businesses where the auditor typically undertakes simple risk assessment procedures.

Overall, we are concerned about the length and complexity of the proposals. Rather than ease the challenge SMPs presently face in trying to understand and apply the risk-based audit approach of the ISAs, we believe the proposals will exacerbate the challenge and result in greater work effort. Ultimately, this may render the audits of smaller and less-complex entities inefficient from a cost benefit perspective. We therefore strongly encourage the Board to redouble its efforts to ensure the scalability of this and other ISAs for audits of smaller and less-complex entities. We believe audits of smaller and less-complex entities yield significant value and benefits to such entities, as our research cited above indicates, and these benefits stand to be dwarfed by excessive costs if ISAs continue to get more complex.

We suggest that scalability can be enhanced by, for example, emulating the approach taken in the recently completed ISA 540 whereby upfront the standard explicitly states that it can be tailored through the professional judgement of the auditor based on the size, complexity and circumstances of the entity.

While we welcome efforts to make the ISA more scalable, including the placement of matters related to scalability at the start of some sections, we question the usefulness of some of the scaling statements in the application material, such as A16.

We question the need and practicality for auditors of small and less-complex entities to have to read and fully understand all the ISAs in order to determine the relevance or otherwise of the content according to different entities circumstances. And we also question the use of 'Special Considerations in the Audit of Small Entities' integrated into the text. Some SMPs believe this impairs usability and is unhelpful. Moreover, we would argue that a truly scalable standard would not need 'Special Considerations in the Audit of Small Entities' but rather 'Special (or Additional) Considerations (or Requirements) in the Audit of Larger / Complex Entities etc.'

Small entities will typically use off the shelf commercial software that cannot be changed by the entity. It should be made clear that in these circumstances, the auditor may determine that certain controls over IT applications will not be relevant to the audit and, accordingly, suggest the use of a conditional requirement to help enhance scalability.

We support certain improvements such as: the introduction of a spectrum of risk, as this enhances scalability; and the acknowledgment that communication may be less structured in smaller and less-complex entities (A159), the formality of controls may vary (A161) and it may be less practicable to establish segregation of duties (A164).

We are less supportive of much of the new concepts introduced which seem over engineered and confusing for example: inherent risk factors which overlap considerably; the definitions of relevant assertions and significant classes of transactions, account balances and disclosures; and a new level of risk assessment which involves consideration of 'potential' risks before actual risks are considered. We also question the merits of requiring a risk identification not only at financial statement level and for inherent risk but also at a level below assertion level, often known as 'drill down'. We understand that the work effort required involves a drill down identification of every departure from an accounting requirement that could go wrong below assertion level. Such a work effort is excessive and undermines cost: benefit balance in a smaller and less-complex entity environment.

We recognize the unresolved differences of opinion regarding the need for auditors to understand controls where a fully substantive audit approach is taken. We hope that the IAASB's project on the audit of smaller and less-complex entities will, amongst other things, investigate alternatives to mandating work on the design and implementation of controls and so we question the merits of inserting the new and untested additional material on IT and controls into the standard itself at this time (as opposed perhaps to the appendices). We note that firms are tending to move away from testing certain controls and conducting analytical procedures and towards extensive tests of details and this trend may accelerate thanks to advances in the use of data analytics. Overall, the standard reads as if to support large firm approaches rather than as a principles-based standard.

Further guidance, including examples and illustrations, will be necessary to help ensure consistent and scalable application. While this is onerous the IAASB is best place to produce its own examples and this also removes duplication of effort by national standard-setters and professional accountancy organizations. Examples will be especially useful for: the nature and extent of work on the design and implementation of controls in substantive audits; evaluating where a risk should be placed on the spectrum of risk; and documentation of these and understanding of the business model, the control environment, the entity's risk assessment process and its process to monitor controls. Smaller entities may not have complete documentation of policies and procedures making up their internal control system. We fear the potential work effort and related documentation proving excessive.

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?

We agree with the IAASB's approach to use the term automated tools and techniques in the ED.

The rapid integration of digital technologies into the financial reporting and auditing process is a key challenge for the profession. Accordingly, ISAs need to accommodate and anticipate this development and demonstrate the compatibility of the risk-based audit approach of the ISAs with such automation. The Board, therefore, is right to modernize this ISA and others for such developments.

As we state under our general observations above while we welcome the inclusion of automated tools and techniques in ED-315 we note this is only done in the application material supported by some examples. We suggest the Board affords this more prominence and consider how these tools and techniques can be used to provide sufficient and appropriate audit evidence.

We believe that the term ‘data analytics’ is too narrow since it may not encompass all of the emerging technologies that are being used when performing a risk assessment and audit procedures. While we accept that this will be considered further as part of the IAASB’s upcoming Audit Evidence project, we believe it would be very helpful if separate implementation support could be developed to cover significant existing challenges in practice. We especially welcome guidance on the audit procedures for commercial off the shelf software, how to deal with security issues when using the cloud, and how to audit primarily online or app businesses and the risks.

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?

We agree that the proposals encourage exercise of professional skepticism throughout the risk identification and assessment process. IAASB standards in isolation, however, will unlikely significantly enhance professional skepticism. Professional skepticism is largely determined by the education and mindset of the auditor. We refer you to [our response](#) to the IESBA Consultation Paper, [Professional Skepticism – Meeting Public Expectations](#).

SPECIFIC QUESTIONS

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:

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 question the need for auditors to understand controls where a wholly substantive audit approach is taken. We believe, and our research cited above supports, some high level understanding of controls, and particularly the controls environment, is necessary regardless of the audit approach. We fear, however, that the extent of design and implementation work required under these proposals and the volume of material on controls and IT generally will only re-enforce the belief in many that ISAs undermine the cost effectiveness and efficiency of smaller audits.

We note that requirement 21 states that the auditor shall ‘evaluate’ whether information from audit procedures performed in previous audits remains relevant and reliable. This may imply undue work effort so suggest that ‘consider’ is more appropriate.

To facilitate the efficient performance of smaller entity audits we suggest the application material clarify the differences in work required for evaluating the control environment

(req. 27 & 28), the entity's risk assessment process (req. 29-31) and controls relevant to the audit (req. 39-42).

- 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 believe they have been enhanced and clarified.

We suggest, however, inclusion of specific acknowledgement that in audits of smaller and less complex entities, in which a fully substantive approach is taken, there are likely to be few controls relevant to the audit that are appropriate to evaluate for their design and implementation.

We question the need for the auditor to test the design and implementation of controls that address significant risks not subject to complexity when auditors believe that they can respond to the risks of material misstatement through substantive procedures alone. Further, we question whether an auditor in an SME environment always needs to understand the nature of controls relating to managements risk assessment process, or its monitoring of controls (para. 39(e)).

ED-315 explains that in smaller entities internal control is more in-formal. ED-315, however, does not provide guidance whether and how these more informal controls can be tested. We urge the Board to provide guidance on testing controls within such entities.

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

We support the added emphasis on IT in ED-315. However, as we note under our general observations above, ED-315 tends to treat IT as a stand-alone issue and describes its impact and application in a highly complex and detailed manner. IT controls are the norm and so need to be seamlessly integrated into the audit and ISAs. Accordingly, we suggest integrating IT controls and simplifying the text.

As noted in our response to Q2 we are concerned over the increase in material on IT and controls at a time when technology seems to be encouraging firms to move towards tests of details. We encourage simplification of the concepts, definitions and application material. Such is the pace of change we fear that material will rapidly become obsolete and redundant so the simpler and more principles-based the better.

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:

- 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 have no comments.

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

We have no comments.

- 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?**

While we welcome the concept of ‘spectrum of inherent risk’ we believe understandability will be improved via the inclusion of an illustrative figure.

- 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 are concerned that the new concepts and definitions of significant are complex and voluminous and demand simplification. As we stress under our ‘General Remarks’ we believe PCAOB concepts and terminology are inappropriate for ISAs designed for use in audits of entities of all size and complexity.

- 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 have no comments.

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?

We have no comments.

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 have no comments.

CONFORMING AND CONSEQUENTIAL AMENDMENTS

Q9. 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)?**

We have no comments.

- 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?**

We have no comments.

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

We have no comments.

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

We have no comments.

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?

We have no comments.

REQUEST FOR GENERAL COMMENTS

Q11. 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.**

We are not aware of any issues.

- 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 hope the final standard will be much shorter and simpler since as it stands it will be. If, however, the final standard remains long and complex then we suggest a longer period to the effective date. We encourage the IAASB to publish the final document in draft form ahead of PIOB approval to facilitate adoption processes at a national level.

CONCLUDING COMMENTS

We trust that the above is clear, but should you have any questions on our comments, please do not hesitate to contact me.

Yours faithfully,



Bodo Richardt

President