



October 31, 2018

Mr. Daniel Montgomery  
Interim Technical Director  
International Auditing and Assurance Standards Board  
529 Fifth Avenue  
New York, NY 10017

**Re: Exposure Draft: Proposed International Standard on Auditing (ISA) 315 (Revised),  
*Identifying and Assessing the Risks of Material Misstatement (ED-315)***

Dear Mr. Montgomery:

The American Institute of Certified Public Accountants (AICPA) Auditing Standards Board (ASB) is pleased to respond to the International Auditing and Assurance Standards Board's (IAASB) above referenced exposure draft.

The AICPA is the world's largest member association representing the accounting profession, with more than 431,000 members in 143 countries and a history of serving the public interest since 1887. AICPA members represent many areas of practice, including business and industry, public practice, government, education, and consulting. Among other things, the AICPA sets ethical standards for the profession and U.S. auditing standards (generally accepted auditing standards or GAAS) for private companies, nonprofit organizations, and federal, state and local governments (nonissuers).

As set forth in the Explanatory Memorandum to ED-315 (Explanatory Memorandum), ED-315's proposals are intended to enhance the auditor's risk assessment process, with the objective of establishing more robust requirements and appropriately detailed guidance to drive auditors to perform consistent and effective identification and assessment of the risks of material misstatement.

We are supportive of the IAASB's project to enhance extant ISA 315 (revised), *Identifying and Assessing the Risk of Material Misstatements through Understanding the Entity and its Environment*, because risk assessment is a fundamental concept that guides auditors to identify and assess the risks of material misstatement and thereby provides the basis for the design and performance of the auditor's overall responses and further audit procedures that are responsive to those risks.

As set forth in the ASB's operating procedures, convergence with the International Standards on Auditing (ISAs) is a key strategic objective. Accordingly, the ASB is keenly interested in the development of standards by the IAASB that are fit for purpose for the U.S. audit profession and various stakeholders. In that context, we have noted certain general observations and overall comments as well as specific responses to the questions presented in ED-315. We have provided our overall comments in the following section. In the appendix to this comment letter, we have provided our specific responses to the questions presented in ED-315.

## **Overall Comments**

### *Length and Understandability*

We appreciate the IAASB's significant efforts to provide application material to guide auditors with respect to the risk assessment process, some of which was responsive to recommendations from ASB task forces and other AICPA personnel. That said, when we evaluate ED-315 in its entirety, we believe its sheer length will create challenges to its comprehension by auditors and may hinder effective implementation of the ISA. Specifically, the volume of application material in ED-315 may obscure key aspects of the approach to risk assessment that the IAASB is intending to enhance. For example, with respect to the area of internal control, we believe that the intent of the IAASB is to enhance the clarity of the work effort around internal control and clarify what is meant by "controls relevant to the audit." However, the level of the work effort that is required in this area is not readily evident in the application material, especially for situations in which the auditor does not plan to test the operating effectiveness of controls and thus plans to limit the auditor's further audit procedures to substantive procedures.

We believe this standard presents an excellent opportunity to investigate alternative ways to provide guidance to auditors, while drafting requirements and application material in a principles-based manner that enhances the likelihood of effective implementation by auditors and reduces the risk of material becoming outdated in the future.

To that end, we recommend that the IAASB revisit the application material to limit its content to guidance that is necessary to assist auditors in understanding the requirements and focusing on the key concepts.

Other guidance in the application material could be relocated to an International Auditing Practice Note (IAPN) wherein the guidance can be enhanced with more details, additional examples, or case studies. For example, an IAPN could focus and expand on practice issues that have persisted since the original issuance of ISA 315, such as providing guidance related to 1) the degree of understanding of internal control necessary in situations when the auditor does not intend to test operating effectiveness of controls, but instead plans to limit further audit procedures to substantive procedures, 2) identifying controls relevant to the audit, and 3)

identifying significant risks. Further examples of application material that may be more appropriate for an IAPN, and thus present an opportunity to reduce the length and improve the understandability of the standard, include:

- Descriptive material related to information technology, such as paragraphs A7 and A8
- Examples of information the auditor may consider, such as paragraphs A18, A19, and A35
- Examples that illustrate how an entity may implement elements of its internal control, such as in paragraph A73 and A74

Also, we note that increased use of headings and sub-headings may also help in the organization and readability of the content.

Finally, we suggest that the IAASB review ED-315 for consistent use of terminology; for example, ED-315 refers to the term “inherent risk factors” in some paragraphs, but in other paragraphs uses the terms “matters” or “factors”, which appear to be intended to have the same meaning. It is also unclear in places whether they are or are not intended to mean the same thing.

### *Scalability*

We appreciate the effort to propose a risk assessment approach that is scalable, in particular as the risk assessment approach for private company audits contemplates different financial statement users than listed entity audits. In that regard, we note that paragraphs A106, A120 and A123 discuss the informal nature of elements of a system of internal control in many smaller, less complex entities. Due to the importance in ED-315 of the determination of whether controls have been implemented, we recommend these paragraphs also note that such elements may not be clearly documented, depending on management’s resources and other considerations. Therefore, it may be necessary for the auditor to observe other evidence in obtaining an understanding of the elements in such entities, for example, management’s review of the monthly financial statements whereby such review is demonstrated by e-mail or other electronic correspondence evidencing that such review occurred, instead of initials or the completion of a hardcopy checklist. We believe acknowledgement of situations in which controls are not formally documented combined with guidance about observing such indirect documentation of the operation of controls, would enhance the scalability of the standard in audits of these entities.

Additionally, given the current profession focus on controls consisting of management review of the accounting for transactions or events outside of routine transaction cycles, particularly in the context of controls over significant estimates and nonstandard journal entries, we recommend that the guidance in paragraphs A160–A165 be enhanced to address the extent to which an auditor needs to understand the specific control procedures performed by management, and the controls over data used by management in performing these procedures. This additional guidance

could be addressed in an IAPN instead of in the application material. Articulation of expectations of the auditor in this area could significantly impact the scalability of the standard. For example, the degree of understanding of these details may vary in smaller, less complex entities. If an entity has a strong control environment, it may be more likely that a management review control is being performed conscientiously and effectively, whereas in an entity with a poor control environment, the auditor may need to make more detailed inquiries about how the individual performs the control to reduce the risk that to the auditor inappropriately designs further audit procedures based on an inadequate understanding of the extent to which the control has been implemented.

Finally, we found Appendix 1 to the Explanatory Memorandum very helpful in highlighting the specific paragraphs where the IAASB intended to address issues of scalability. We recommend that this Appendix be retained as an appendix to the final standard.

#### *Understanding Internal Control*

We suggest that the IAASB more fully articulate in the standard why it is necessary to gain an understanding of internal control in an audit of financial statements. For example, in an audit of an entity's financial statements, the objective of gaining an understanding of internal control is to provide a reasonable basis to assess control risk and thereby assess the risks of material misstatements. The auditor's understanding of internal control also may inform the auditor in designing and performing the nature, timing, and extent of further audit procedures. Finally, while gaining an understanding of internal control, the auditor may identify deficiencies in internal control that would be required to be communicated to those charged with governance and management in accordance with ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance*.

#### *Overall Approach to Risk Assessment*

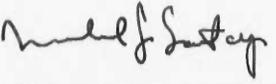
We recommend that the IAASB highlight, as part of the introductory material, a general overview of an effective risk assessment process, including the need for the auditor to first apply a top-down approach in identifying and assessing risks, including identifying significant classes of transactions, accounts balances and disclosures. Following this initial consideration, the auditor then focuses on how those risks may affect the risk of material misstatements at the assertion level. We believe describing this top-down approach would help auditors better understand how the standard is intending to focus the auditor on risks relevant to the financial statements and controls relevant to the audit.

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Mr. Daniel Montgomery  
October 31, 2018

Thank you for the opportunity to comment on this exposure draft. If you have any questions regarding the comments in this comment letter, please contact me at [Mike.Santay@us.gt.com](mailto:Mike.Santay@us.gt.com) or Hiram Hasty at [Hiram.Hasty@aicpa-cima.com](mailto:Hiram.Hasty@aicpa-cima.com).

Respectfully submitted,

A handwritten signature in black ink on a light gray background. The signature is cursive and reads "Michael J. Santay".

/s/ Michael J. Santay

Chair, Auditing Standards Board

## Responses to ED-315 Questions

### *Overall Questions*

- 1) *Has ED-315 been appropriately restructured, clarified and modernized in order to promote a more consistent and robust process for the identification and assessment of the risks of material misstatement. In particular:*
  - (a) *Do the proposed changes help with the understandability of the risk identification and assessment process? Are the flowcharts helpful in understanding the flow of the standard (i.e., how the requirements interact and how they are iterative in nature)?*
  - (b) *Will the revisions promote a more robust process for the identification and assessment of the risks of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6–28?*
  - (c) *Are the new introductory paragraphs helpful?*

**Response:** We believe that the introductory paragraphs are helpful in guiding readers as they navigate the standard. Given the iterative nature of the risk assessment process, the introduction provides a necessary bridge that allows for a more fulsome understanding of the interaction among the paragraphs. As stated above, we do believe the application material can be streamlined. We do support the inclusion of flow charts, however, we note that the need for such charts may be an indication that the standard as written is difficult to understand and adopt.

Paragraph 4 — This paragraph contains the following statement: “...The identification of risks of material misstatement at the assertion level is performed before consideration of any controls...” Because the definition of the term “risk of material misstatement” in paragraph 13 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance International Standards on Auditing*, includes both inherent risk and control risk, we do not believe that this statement is technically accurate and could cause some confusion at the outset of an auditor’s reading of the standard. We recommend this paragraph refer to inherent risk rather than the broader risk of material misstatement.

Also, we believe the statement “The auditor does so based on a *preliminary* [emphasis added] assessment of inherent risk that involves identifying those risks for which there is a reasonable possibility of material misstatement” may create a question as to

whether the auditor would be required to document two separate assessments of inherent risk, the preliminary assessment of inherent risk and then the final assessment of inherent risk. We understand the intent of the IAASB in paragraph 4 is to introduce the iterative nature of the risk assessment process and to emphasize that the auditor initially obtains an understanding of the entity and its environment, including internal control, and that this understanding can evolve as the auditor conducts the audit. We suggest the focus of the paragraph be changed from making a preliminary assessment to gaining an initial understanding of the entity and its environment, including internal control, to enable the auditor to provide an appropriate basis for identifying the classes of transactions, account balances and disclosures to be expected in the entity's financial statements.

To reduce the risk of misunderstanding the extent to which the iterative nature of the process requires documentation of changes to the identification and evaluation of risks of material misstatement, we recommend paragraph 54(d) clarify that the documentation required by that sub-paragraph is limited to the final determination of identified and assessed risks of material misstatement.

- 2) *Are the requirements and application material of ED-315 sufficiently scalable, including the ability to apply ED-315 to the audits of entities with a wide range of sizes, complexities and circumstances?*

**Response:** Please see our Overall Comments above and also refer to our comment regarding paragraphs 27–34 below with respect to clarifying the work effort required in gaining an understanding of internal control.

- 3) *Do respondents agree with the approach taken to enhancing ED-315 in relation to automated tools and techniques, including data analytics, through the use of examples to illustrate how these are used in an audit (see Appendix 1 for references to the relevant paragraphs in ED-315)? Are there other areas within ED-315 where further guidance is needed in relation to automated tools and techniques, and what is the nature of the necessary guidance?*

**Response:** We agree with the approach taken, and we believe that no further guidance is necessary in the application material of the standard. However, we encourage the IAASB to consider additional projects to develop guidance for which the auditor's understanding of potential data analytics, including use of emerging technologies, could be further enhanced.

- 4) *Do the proposals sufficiently support the appropriate exercise of professional skepticism throughout the risk identification and assessment process? Do you*

***support the proposed change for the auditor to obtain ‘sufficient appropriate audit evidence’<sup>1</sup> through the performance of risk assessment procedures to provide the basis for the identification and assessment of the risks of material misstatement, and do you believe this clarification will further encourage professional skepticism?***

**Response:** Given that paragraph 5(e) of ISA 500, *Audit Evidence*, states that sufficiency is affected by the auditor’s assessment of the risks of material misstatement, we do not believe the concept of “sufficient appropriate audit evidence” is an appropriate requirement with respect to the auditor’s responsibilities for the risk assessment process. While we acknowledge that risk assessment procedures do provide audit evidence, we believe it is difficult to conceptualize and implement a notion of “sufficient appropriate audit evidence” at this stage of the audit as it is a concept specific to evaluating the responses to the identified risks.

In addition, the inclusion of the notion of sufficient and appropriate audit evidence in ISA 315 may have unintended consequences. We note that in ISA 500, the concept of “appropriateness” encompasses both relevance and reliability. Determining reliability often requires the auditor to perform audit procedures, such as testing for completeness and accuracy, to evaluate the information to be used as audit evidence. Therefore, introducing the concept of appropriateness as part of risk assessment might suggest that the auditor would be required to perform specific procedures to test the completeness and accuracy of the information being used for risk assessment purposes. We do not believe that such deeper work effort is necessary in many circumstances and therefore may not be appropriate at the risk assessment stage of the audit. Instead, we recommend that the IAASB consider the approach set forth in the Public Company Accounting Oversight Board (PCAOB) standards, that the objective of the assessment of risks of material misstatement is to obtain an understanding to provide *a reasonable basis* to enable the auditor to identify and assess the risks of material misstatements and to design further audit procedures that are appropriately responsive to those risks.

- 5) ***Do the proposals made relating to the auditor’s understanding of the entity’s system of internal control<sup>2</sup> 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***

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<sup>1</sup> See paragraph 27 of this Explanatory Memorandum and paragraph 17 of ED-315

<sup>2</sup> Paragraphs 25–44 and A89–A200 of ED-315

*enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?*

*(b) Have the requirements related to the auditor's identification of controls relevant to the audit<sup>3</sup> been appropriately enhanced and clarified? Is it clear how controls relevant to the audit are identified, particularly for audits of smaller and less complex entities?*

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

**Response:** We appreciate the IAASB's efforts to expand and clarify the auditor's approach to the understanding of the system of internal control and how and why it is a critical element of the risk assessment process. We note that for many practitioners this is an area that is often not well understood with respect to the need for an appropriate understanding and how the outcomes impact the responses to identified risks. As such, we have provided the following specific recommendations.

We note that often there is a strong interaction between opportunities for committing fraud and the appropriate design and implement of an entity's system of internal control. For these reasons and others such as the expanded use of IT by nearly all entities, we recommend the standard address the notion that in most circumstances it is generally not possible for the auditor to adequately design further audit procedures, including appropriately addressing the risk of fraud, without gaining such an understanding of the system of internal control.

We further recommend the standard provide guidance to the auditor regarding the need to consider the reason(s) management designed and implemented controls, as one source of information about potential risks of material misstatement and note that this aspect of risk assessment is only available when the auditor has obtained an understanding of internal control.

Highlighting the above points, which we believe are fundamental reasons for the requirement to obtain an understanding of internal control in all audits, in the

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<sup>3</sup> ED-315, paragraphs 39–40 and paragraphs 37–40 of this Explanatory Memorandum

introductory section of the standard may be helpful in articulating the conceptual basis for the requirement.

We understand the standard uses the elements of internal control described in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). If it is the intent of the IAASB to be consistent with COSO, we believe that the guidance in the standard should be consistent with the guidance in COSO. For example, it appears that the “information and communication” element in ED-315 may not be consistent with how this element is described in COSO. To enhance auditors’ comprehension of the requirements in this part of the standard, we recommend the standard use a description of the elements that is consistent with COSO, since it uses the same terms and categorization.

Finally, we believe that the PCAOB has useful guidance in the area of evaluating the design effectiveness of internal control. We note that this is an area that is often misunderstood and results in inconsistent application in practice. Therefore, we recommend that the IAASB consider including that guidance in finalizing the standard. Specifically, paragraphs 19 and 20 of AS 2301, *The Auditor’s Responses to the Risks of Material Misstatements*, provide guidance on testing the design effectiveness of controls, including guidance for audits of smaller, less complex companies.

Paragraphs 27–34 — We are concerned about the requirement to evaluate the control environment and risk assessment components (paragraphs 28 and 31a) based on the procedures listed in paragraphs 27 and 29. We believe the requirement should be limited to obtaining an understanding sufficient to assess risks of material misstatement. We recommend the section that discusses obtaining an understanding of the monitoring component (paragraphs 32-34) as an appropriate term for articulating the extent of the understanding that is necessary, without requiring the auditor to make an evaluation that may be premature.

Paragraph 36 — This paragraph states, in part, “The auditor shall evaluate the design of the information system controls relevant to financial reporting”... We are concerned this requirement may be interpreted as requiring the auditor to evaluate *all* controls over financial reporting that the entity might have in place. We recommend the standard clarify this evaluation is not expected to include aspects of the information system that do not have a reasonable possibility of including controls *relevant to the audit*.

We also recommend the standard clarify how the requirement in paragraph 36 interacts with paragraph 39, which deals with controls within the control activities component.

We understand that the intent of the IAASB is to recognize that understanding the financial reporting process used to prepare the entity's financial statements (as described in paragraph 35) is always relevant to the audit. However, we are concerned that the wording of paragraph 36 may be interpreted as requiring evaluation of the information system and communication component taken as a whole (which would not be an appropriate requirement because the auditor would not necessarily have a basis to do so, that is, there are no criteria in the standard to make such an overall evaluation, and this is not the objective of the risk assessment process). The evaluation related to an internal control component should be performed by the auditor at the control level, as described in paragraph 42(a), for those controls relevant to the audit as described in paragraph 39.

To make this approach clearer, we suggest that paragraph 36 be replaced by the following, to be consistent with paragraphs 27 and 38]:

Based on the understanding of the information system and communication component obtained by performing the procedures in paragraph 35, the auditor shall identify the controls relevant to the audit, as described in paragraph 39, that are included in this component.

We also then recommend paragraph 42 be amended to highlight controls relevant to the audit identified within the information system and communication component as follows:

42. For each control identified as relevant to the audit in accordance with paragraphs **36**, 39 and 41, the auditor shall...

Paragraph 50 — This paragraph (and also in application material), the IAASB introduces the term “maximum.” We believe this is problematic because it seems to convey a notion of a precise point in the spectrum of control risk. We believe variations of control risk exist even within the categories of low, medium, or high. Instead of the term “maximum,” we recommend that the IAASB use a term such as “high,” recognizing that firms may use other schemes in the assessment of control risk. This is important in terms of emphasizing the notion that an auditor cannot assess control risk below high without testing operating effectiveness. Assigning of value of “high” in the assessment of control risk would also help the auditor understand that evaluating whether controls are effectively designed and implemented may influence the nature, timing and extent of further audit procedures.

Paragraph A142 — This paragraph describes potential sources of information outside the core accounting system, in support of paragraph 35(a)'s point that such information may

relate to significant classes of transactions, account balances and disclosures. We recommend paragraph A142 also caution the auditor that such information may not have the same internal control environment and structure that information produced by the core accounting system may have.

Paragraph A168 — This paragraph, which is application material for paragraph 39(a), relates to controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence. However, it appears to simply reiterate the requirement and connect it to the requirement to test the operating effectiveness of controls in ISA 330. To help auditors understand when this situation may arise, we believe it would be helpful if paragraph A168 provided one or two examples of when that condition may be present.

Paragraph A194 — This paragraph provides guidance as to how the auditor evaluates the design of controls, specifically, whether they are capable of effectively preventing, or detecting and correcting, material misstatements. We recommend this guidance include consideration of the extent to which the controls, if properly operating, would prevent, or detect and correct, material misstatements, either on their own or in combination with other identified controls. Determining that a control is capable of preventing, or detecting and correcting, material misstatements does not provide the auditor with sufficient information to assess control risk and design further audit procedures.

We note that paragraphs 72–73A of PCAOB Auditing Standards section AS 2110, *Identifying and Assessing Risks of Material Misstatements*, specifically highlight the need to evaluate the design effectiveness of controls related to significant risks, including fraud risks, and significant unusual transactions. ED-315 addresses this by including such controls in the definition of controls relevant to the audit in paragraph 39 and by requiring evaluation of the design effectiveness of such controls in paragraph 42(a). Paragraphs A194–A198 of ED-315 contain some of this guidance, but we believe that the application material in ED-315 could be enhanced by inclusion of the wording in the relevant paragraphs in the PCAOB standards.

Paragraph A199 — We are very supportive of the guidance in this paragraph as well as the guidance in paragraph A200. We believe that these paragraphs are very important in articulating the extent of the requirement to gain an understanding of internal control, and such guidance greatly helps on the issue of scalability. Given the importance of this guidance, we recommend that these paragraphs be more prominently featured in the standard. For example, this guidance could be included in the introductory paragraphs of the standard in perhaps a separate section related to scalability concepts.

We also recommend the discussion of a “spectrum” of control risk in paragraph A233 be given more prominence in the standard, to help the auditor understand there may be varying levels of reliance on controls depending on the extent of testing of operating effectiveness and the auditor’s judgment regarding the degree of effectiveness of controls in preventing or detecting material misstatements.

- 6) ***Will the proposed enhanced framework for the identification and assessment of the risks of material misstatement result in a more robust risk assessment? Specifically:***
- (a) ***Do you support separate assessments of inherent and control risk at the assertion level, and are the revised requirements and guidance appropriate to support the separate assessments’?***<sup>4</sup>
  - (b) ***Do you support the introduction of the concepts and definitions of ‘inherent risk factors’<sup>5</sup> to help identify risks of material misstatement and assess inherent risk? Is there sufficient guidance to explain how these risk factors are used in the auditor’s risk assessment process?***
  - (c) ***In your view, will the introduction of the ‘spectrum of inherent risk’ (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks?***
  - (d) ***Do you support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and their relevant assertions? Is there sufficient guidance to explain how they are determined (i.e., an assertion is relevant when there is a reasonable possibility of occurrence of a misstatement that is material with respect to that assertion),<sup>6</sup> and how they assist the auditor in identifying where risks of material misstatement exist?***
  - (e) ***Do you support the revised definition,<sup>7</sup> and related material, on the determination of ‘significant risks’? What are your views on the matters***

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<sup>4</sup> Paragraphs 45–50 and A201–A235 of ED-315

<sup>5</sup> See paragraph 48 of this Explanatory Memorandum and paragraphs 16(f), A5–A6 and A83–A88 of ED-315

<sup>6</sup> See footnote 26 of this Explanatory Memorandum

<sup>7</sup> Paragraphs 16(k) and A10, and A229–A231, of ED-315

*presented in paragraph 57 of the Explanatory Memorandum relating to how significant risks are determined on the spectrum of inherent risk?*

**Response:** We are generally supportive of the proposed changes, although we note that they are broad in nature and, if adopted, will likely impact the methodologies of many firms fairly significantly. Such changes often result in an iterative adoption process as the auditors become more familiar with the concepts over time. As such, we recommend that the IAASB consider some targeted outreach on certain of the changes (once ultimately adopted), such as those highlighted above. Notwithstanding our support for the changes, we have comments as follows:

Paragraph 16(f) — Susceptibility to fraud is included as an inherent factor. We do not believe that susceptibility to fraud, intrinsically, is *inherent* in a characteristic of events or conditions. ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*, defines fraud, as follows:

An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception that results in a misstatement in financial statements that are the subject of an audit.

Fraud is characterized by the following factors defined in ISA 240:

Events or conditions that indicate an incentive or pressure to perpetrate fraud, provide an opportunity to commit fraud, or indicate attitudes or rationalizations to justify a fraudulent action.

Given the definition of fraud and the related risk factors, we do not believe that susceptibility to fraud should be characterized as an inherent risk factor. If the IAASB determines it is important to specifically cite inherent risk factors related to fraud, we recommend the standard focus on incentives or pressures to commit fraud, accompanied by the inclusion of references to ISA 240 as appropriate.

Paragraph 16(k) — We continue to believe that “significant risk” should be the product of the likelihood *and* magnitude of a potential misstatement. For example, we do not believe that a risk of material misstatement with a high likelihood of occurrence, but which has a remote likelihood of being material (both quantitatively and qualitatively) would ordinarily be assessed as a significant risk. Conversely, a potentially material misstatement with a remote likelihood of occurrence would not ordinarily be assessed as a significant risk. We believe concluding either of these situations may result in a significant risk is inconsistent with the “reasonable possibility” concept which is core to ED 315’s definition of relevant assertions. Also, we recommend that

the application material emphasize that the assessment of likelihood is done without consideration of controls, for purposes of this identification.

Paragraphs 48 and 50 — To further highlight the importance of the focus on, and definition of, relevant assertions, we recommend the standard emphasize that the assessments called for by these paragraphs (and the corresponding response in ISA 330, *The Auditor's Responses to Assessed*) are to be performed for each relevant assertion. We understand that the IAASB's intent is for the auditor to design the work effort to the level at which assertions are relevant, and we believe emphasis of that point in these paragraphs will enhance the auditor's focus on those assertions.

- 7) *Do you support the additional guidance in relation to the auditor's assessment of risks of material misstatement at the financial statement level,<sup>8</sup> including the determination about how, and the degree to which, such risks may affect the assessment of risks at the assertion level?*

**Response:** Yes.

- 8) *What are your views about the proposed stand-back requirement in paragraph 52 of ED-315 and the revisions made to paragraph 18 of ISA 330 and its supporting application material? Should either or both requirements be retained? Why or why not?*

**Response:** We are supportive of the stand-back requirement in paragraph 52 of ED-315. To enhance the standard's clarity about the level of disaggregation at which this requirement is intended to be applied, we recommend paragraph A240 specifically state that the level of detail at which information is presented in the financial statements is not, in itself, determinative of the level at which classes of transactions and account balances are to be defined by the auditor. Also, please refer to our response to question 10) below.

### *Conforming and Consequential Amendments*

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

*(a) ISA 200<sup>9</sup> and ISA 240, are these appropriate to reflect the corresponding changes made in ISA 315 (Revised)?*

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<sup>8</sup> ED-315, paragraphs 47 and A215–A220

<sup>9</sup> Conforming amendments to ISA 200, paragraph A42 will be presented with the conforming amendments to ISA 540 (Revised)

*(b) ISA 330, are the changes appropriate in light of the enhancements that have been made in ISA 315 (Revised), in particular as a consequence of the introduction of the concept of general IT controls relevant to the audit?*

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

*(d) ISA 540 (Revised) and related conforming amendments (as presented in the Supplement to this exposure draft),<sup>10</sup> are these appropriate and complete?*

**Response:** We are generally supportive of the proposed conforming amendments, however we offer the following changes:

The term ‘internal control’ was replaced by the term “system of internal control.” Several conforming amendments were marked to ISA 210, *Agreeing to the Terms of Audit Engagements*, ISA 260, *Communicating with Those Charged with Governance*, and ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, and we agree with these conforming amendments. However, other ISAs in which the term is used (such as the 700 series) were not marked for conforming amendments. We recommend that the IAASB review the other uses of the term “internal control” within the ISAs to determine whether additional conforming amendments should be made to reduce the likelihood of confusion with respect to this critical concept.

Finally, we recommend the IAASB clarify how the use of the term “assessed the risk of material misstatement as low” in paragraph 15(a) of ISA 505, *External Confirmations*, operates in the context of the “spectrum of risk” concept in ED-315.

**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?**

**Response:** Paragraph 18 of ISA 330 states: “Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.” We believe that this requirement is counterintuitive to, and may undermine the effectiveness of, the risk assessment process in ISA 315, particularly in view of the enhancements being proposed by ED-315. That is, the auditor is required to identify and assess the risks of material misstatement in order to design tailored audit responses. In addition, the stand-back requirement in paragraph 52 provides an opportunity to again consider the assessed risks, with a specific focus on material classes of transactions, account

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<sup>10</sup> Published in late July 2018

balances, and disclosures that the auditor has not identified as significant. If an auditor would be required to perform substantive audit procedures regardless of the assessment of risks of material misstatement under ISA 315, then the objective of performing the work effort under ISA 315 could be questioned as well as the enhanced approach related to assessing the system of internal control. Accordingly, we recommend that paragraph 18 of ISA 330 be eliminated.

However, if the IAASB makes the decision to retain paragraph 18 of ISA 330, then we do not believe the proposed conforming amendments to that paragraph are necessary. ED-315 proposes paragraph 18 of ISA 330 be amended to explicitly state that the auditor's consideration of materiality includes quantitative and qualitative factors in designing and performing substantive audit procedures for classes of transactions, account balances, and disclosures. We believe that such quantitative and qualitative considerations are inherent in the concept of materiality in the ISAs, and therefore we do not believe that the conforming amendments are necessary.

In addition, if paragraph 18 of ISA 330 is retained, we recommend application material be added to provide guidance as to how the auditor should determine which assertions should be addressed in designing and performing further audit procedures, given that this requirement only applies to classes of transactions, account balances, and disclosures that the auditor has determined, through the ISA 315 process, do not contain relevant assertions.

### ***Request for General Comments***

***11) In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters set out below:***

- (a) Translations—recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-315.***
- (b) Effective Date—Recognizing that ED-315 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.***

**Response:** We believe that the proposed changes contemplated in ED-315 may necessitate significant methodology changes that could require substantial time and resources to place in operation, particularly for global firms and networks. Therefore, an 18-month after approval effective date may not be sufficient for such methodologies. We recommend at least a 24 month period.

***Other Comments***

Paragraph 16(a) — This paragraph includes a new definition of application controls which includes manual and automated controls. We believe that, in practice, many auditors presume that application controls relate to automated controls and do not intuitively associate the term “application controls” with manual controls. Thus, we believe that the definition of application controls is not consistent with current practice. Because the term is not pervasively used in the ISAs, we recommend the IAASB reconsider whether the definition of application controls is needed. Alternatively, we suggest that the IAASB use another term (such as “transaction controls”, as used in the COSO framework) to refer to those controls.

Paragraph A117 — This paragraph provides guidance about matters that the auditor may consider in gaining an understanding about how management and those charged with governance have identified business risks relevant to financial reporting objectives. A consideration is whether the potential for fraud when considering the risks to achieving the entity’s objectives has been considered. We note that paragraph 17(a) of ISA 240 includes a requirement for the auditor to make inquiries regarding management’s process for identifying and responding to risk of fraud in the entity. To make a better linkage between the entity’s risk assessment process and consideration of the risks of fraud, we recommend the IAASB include a reference in paragraph A117 to paragraph 17(a) of ISA 240.