

Joint submission by Chartered Accountants Australia and New Zealand and The Association of Chartered Certified Accountants

2 November 2018

To: Professor Arnold Schilder
The Chairman
International Auditing and Assurance Standards Board
529 5th Avenue 6th Floor
New York 10017
United States of America

Submission via IAASB website

Submission on IAASB's Exposure Draft 315

This submission is made jointly by Chartered Accountants Australia and New Zealand (CA ANZ) and the Association of Chartered Certified Accountants (ACCA) under our strategic alliance.

ACCA and CA ANZ created a strategic alliance in June 2016, forming one of the largest accounting alliances in the world. It represents 800,000 current and next generation accounting professionals across 180 countries and provides a full range of accounting qualifications to students and business. Together, ACCA and CA ANZ represent the voice of members and students, sharing a commitment to uphold the highest ethical, professional and technical standards. More information about ACCA and CA ANZ is contained in Appendix A.

We appreciate the opportunity to comment on the Exposure Draft 315 ("ED-315"). Our responses to the specific matters for comment raised in ED-315 follow in Appendix B.

Yours sincerely

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Appendix A

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 121,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

About ACCA

ACCA is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people around the world who seek a rewarding career in accountancy, finance and management.

ACCA supports its 208,000 members and over 503,000 students in 179 countries, helping them to develop successful careers in accounting and business, with the skills required by employers.

ACCA works through a network of 104 offices and centres and more than 7,300 Approved Employers worldwide, who provide high standards of employee learning and development. Through its public interest remit, ACCA promotes appropriate regulation of accounting and conducts relevant research to ensure accountancy continues to grow in reputation and influence.

The expertise of our senior members and in-house technical experts allows ACCA to provide informed opinion on a range of financial, regulatory, public sector and business areas, including: taxation (business and personal); small business; audit; pensions; education; corporate governance and corporate social responsibility.

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We are broadly supportive of the proposed methodology in ED-315 but feel that the language and structure need extensive revisions to promote consistent application.

We are broadly supportive of the proposed methodology, which we believe has the capacity to enhance the auditor's risk assessment procedures, and therefore increase audit quality.

However, as outlined below, we have some serious concerns about the language and structure of the proposed revision to the standard, which we believe may prevent consistent application. In particular, there is an urgent need for the complex language used in the standard and its complex structure to be revised. We believe that standards should be written using the clearest language and simplest structure in order to enable users to understand them, and therefore apply them, in the manner intended.

The exposure draft includes requirements in the Introduction and/or Definitions sections which are not included elsewhere in the standard.

We believe that the Requirements of a standard should be capable of being understood on a standalone basis. In other words, the Introduction and Definitions sections of a standard should be detachable from the rest of the standard. The Introduction should provide an overview of the standard's objectives and its context in relation to other ISAs, as well as a summary of some of its key concepts. The Definitions section should outline the terms used in the standard which are essential to understanding how the standard is to be applied.

The draft standard has some terms which are included only in the Introduction and/or Definitions sections and which are not included elsewhere in the Requirements. Our response to Question 1(c) refers to specific examples.

The exposure draft includes terms which, while they are appropriately defined in the standard, are not defined until later on in the standard.

We believe that the ED-315 is hindered by its structure, in which several terms are used before they are explained. While some of these terms are explained in the Definitions section, we believe this section should be detachable to the rest of the standard and should not be necessary preparatory reading.

For example:

- Paragraph 26 requires the auditor to identify 'controls relevant to the audit' but does not explain what these are until paragraph 39.
- Paragraph 17 requires the auditor to perform 'risk assessment procedures' but does not explain what risk assessment procedures are until paragraphs 18-25. It would be better to explain what the auditor is supposed to do and to define these requirements as 'risk assessment procedures'.

While providing useful background, large amounts of the application material are not essential to an understanding of how to comply with the ISAs and could be moved to an appendix.

For application material to be useful to practitioners, it has to be accessible. With 247 paragraphs of application material across 55 pages, it is unclear that this objective has been met.

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We suggest that where application material is not essential it is either moved to an appendix or deleted. As an example, we feel that a great deal of the section on the components of internal control (A99-A165) could be amalgamated with appendices 3 and 4.

We have received a large number of detailed comments on many of the paragraphs of the requirements and application material.

Unfortunately, the Explanatory Memorandum and Exposure Draft were only supplied in a locked PDF format that does not allow for mark-up comments or copying. The request for comments contained three pages of detailed questions, which needed to be transcribed so that respondents could answer them. We have only highlighted our high-level points in this submission. In addition to these high level points, we have a large number of detailed comments and suggested mark-up changes, which may address some of the issues of structure, language and sequence within the standard, but the locked PDF format does not make it easy for us to share those comments and suggested edits.

The recent publication of the 'At a glance' document for ISA 540 is an excellent demonstration of how complex standards can be presented in a simple, accessible way. We wonder if the IAASB's standard-setting could be approached in a similar manner, building from the basics up. In IAASB's continuous drive for global alignment of its professional standards and consistent application of its standards to achieve quality audit and assurance work, it will be critical to review how drafting of standards can be improved.

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Appendix B

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)?**

We believe that ED-315 restructuring is heading in the right direction, particularly in modernizing and updating the ISA for an evolving business environment taking into consideration the technological advances. ED-315 recognises that auditors are continuously increasing the use of automated tools and techniques such as data analytics.

We are supportive of the broad methodology that underpins ED-315 as it expands on the concepts first introduced in ISA 540 (Revised), such as the inherent risk factors and the separate determination of inherent and control risk.

However, the complexity of the language used throughout the standard, together with its structure, makes it extremely difficult for readers to follow. Because ED-315 introduces many new concepts and its methodology is changed substantially compared to extant, it is very important that the standard uses plain language and a simple structure to ensure that those concepts are understood by practitioners and applied consistently and in the manner intended. As a consequence of the complex language and structure, we do not believe that the revisions will promote a more consistent and robust process for the identification and assessment of the risks of material misstatement. We stress that our response is based on the language and structure of the proposals, rather than the methodology. However, the effort required to address the language and structure should not be underestimated.

We believe that the flowcharts were very helpful in understanding the flow of the standard and in our opinion they should be incorporated as appendices. However, the fact that there is a need for three separate flowcharts and lengthy introductory paragraphs to help with the understanding of the flow of the standard should be considered a warning sign regarding the complexity of the structure and language used. While there is potentially a place for flowcharts in standard-setting, we do not think they are a substitute for clear drafting and well-structured standards.

- (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?**

ED-315 sets a threshold of 'reasonable possibility' of material misstatement for the identification and assessment of the risks of material misstatement. Paragraph 16(h) states that 'reasonable possibility' means the same as a 'more than remote' likelihood.

We do not support defining these two terms as equivalent within the standard. In English, and potentially in common law, they have different meanings. If the desired level of likelihood is 'reasonable possibility' then the simplest approach is to use that term without having to define a different term as having equivalent meaning. Without a single clear definition of the likelihood

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required, we do not feel that it is sufficiently clear which controls are relevant to the audit. If 'more than remote' must be retained, then it should be included separately in the definitions and explicitly defined to mean 'reasonable possibility'. More clarity is needed as to what the IAASB's intention is here.

(c) Are the new introductory paragraphs helpful?

We appreciate having introductory paragraphs to help navigate through the standard, however, these do not substitute high-quality drafting in the standard as a whole. As noted above in our general comments, we believe the Requirements of the standard should be complete, understandable and capable of being applied on a standalone basis, as envisaged in the IAASB's Clarity Center which says that requirements shall be stated clearly.

According to the clarification provided during the Q & A webinar held on 3 October 2018, introductory paragraphs of ISAs do not carry the same authority as the requirements of the standard and are included for explanatory purposes. We noticed however, that some terms have been included in the introductory paragraphs or definitions, and appear in the Application and Explanatory Material, bypassing the Requirements. As a result, the structure of the standard is unnecessarily complex and makes it difficult for practitioners to implement these new concepts. For example:

- The term 'reasonable possibility' is used in paragraph 4 of the Introduction and paragraph 16(h) of the Definitions, but does not otherwise appear in the Requirements.
- The term 'spectrum of inherent risk' is used in paragraph 5 of the Introduction and referred to in paragraph 16(k) of the Definitions, but does not otherwise appear in the standard's Requirements. While we understand the spectrum of inherent risk to mean that the work effort in accordance with ISA 330 should be responsive to the level of inherent risk, the standard should make that link explicit.
- The term 'significant risk' is defined in paragraph 16(k) of the Definitions with reference to risks that are close to the upper end of the spectrum of inherent risk due to the degree to which... the inherent risk factors affect the likelihood... or the magnitude of potential misstatement'. The Requirements do not otherwise explain how to determine a significant risk. We have further comments about the spectrum of inherent risk and determination of significant risk in our response to Question 6(c).
- The term 'relevant assertions' is defined in paragraph 4 of the Introduction and in paragraph 16(h) of the Definitions but is not further elaborated on in the Requirements. Taking into consideration the introduction of new concepts and the overall complexity of ED-315, practitioners should be able to understand such terms by reading the Requirements without the need to refer to the Definitions for each and every term used.
- The term 'significant classes of transactions, account balances and disclosures' is used in the Introduction and is defined in paragraph 16(j) but is not further elaborated on in the Requirements.

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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?

We believe that the methodology of ED-315 has the potential to be sufficiently scalable. We support the approach taken by the task force in including a specific paragraph on scalability early in the introductory paragraphs.

In order for ED-315 to fulfil its potential to be scalable, practitioners need to be able understand the requirements and the procedures it contains. As we have already stated, we believe ED-315 as currently drafted is overly complex and too long. This raises concerns that it will be difficult for smaller practices and sole practitioners to understand. Due to its complexity, the implementation of the revised requirements is likely to take a long time and effort to be adopted into firms' methodologies and the costs of doing this will fall disproportionately on smaller practices.

ISA 315 is a pivotal standard in establishing the work effort of the auditor throughout the audit and therefore it is critically important to get it right. To be sufficiently scalable, it is necessary to restructure the standard and to rewrite it in simpler language, and we appreciate that this will require significant effort. We would also anticipate the final standard to be supplemented by an implementation support process at the level accorded to the more critical and complex projects. Examples of implementation support could include what documentation might look like for a smaller practice and flowcharts to assist practitioners' understanding of the standard.

The reference made to 'smaller and less complex' raised a number of questions as to whether the same guidance is applicable in the case of 'large and less complex' entities too. Although we do understand that it is based on professional judgement, the reference made to both size and complexity causes confusion. We suggest making reference only to complexity, rather than size, as this seems to be the main driver of the work effort in the standard, while noting that size may be an indicator of the level of complexity.

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?

We agree with the approach taken in relation to automated tools and techniques, such as data analytics. We are particularly in favour of recognising that there are various automated tools and techniques with data analytics only being one of them. Furthermore, it is positive to see that it is also recognised that not all audits will involve the use of automated tools and techniques.

We therefore consider it vital that the guidance is included, allowing practitioners to be comfortable in using such tools and techniques. The guidance can be enhanced by referring to specific examples of how such automated tools and techniques can be applied to less complex audits. The guidance can also make reference to when it is appropriate to use such tools and techniques and when it can be relied on.

We welcome the recognition in the Application and Explanatory Material that risk assessment procedures may sometimes be performed concurrently with substantive procedures or tests of controls. It would be helpful for there to be further guidance on how this might be documented, including how the auditor should satisfy themselves on data integrity. One often-raised question on

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data integrity relates to the difference in work effort that might be applied to data used solely for the purpose of risk assessment as compared to data that forms part of the evidence in a test of control or substantive procedure.

- 4) Do proposals sufficiently support the appropriate exercise of professional skepticism throughout the risk of 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 scepticism?**

We recognise that the introduction of 'sufficient appropriate audit evidence' in ED-315 is an attempt to align with the guidance paragraph A10 of ISA 500 which mentions that evidence can be obtained through risk assessment procedures. However, the use of ISA 500 terminology creates a concern that the documentation requirements of ISA 500 are intended for risk assessment procedures under ED-315. It seems the purpose of 'sufficient appropriate audit evidence' is to ensure that auditors perform sufficient procedures and document them appropriately in order to support their risk assessments. This could be stated in simpler language without referring to the terminology of audit evidence explicitly to achieve the same desired result.

We are of the opinion that professional scepticism is 'a state of mind' that cannot be instilled by referring to the term more frequently in standards. Regulators usually focus on the evidence documented around professional scepticism and ED-315 does not have a lot more information around documentation than the extant standard.

We noted some areas where the Application and Explanatory Material could make a clearer connection between higher risks of management bias and fraud and the need for heightened professional scepticism, such as in paragraphs A70-A78 and A83-A88. Other areas where the Application Material could refer specifically to professional scepticism include:

- In paragraphs A41-A45 (discussion among the engagement team), the guidance could warn of the danger of groupthink for the exercise of professional scepticism, and could articulate some ways to mitigate it.
- The guidance could be more explicit about anchoring bias, for instance in paragraph A47.

Specific Questions

- 5) 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 are concerned that some elements of the control environment as per paragraph 27 might be hard to evidence. Therefore, we would expect some guidance in the form of examples of what documentation might be expected.

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- 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?**

The trigger for determining controls relevant to the audit is the 'reasonable possibility'/'more than remote' test. As noted in our response to Question 1(b), we do not support defining these two terms as equivalent.

- 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 are broadly supportive in principle of the new material on IT-related concepts and definitions.

However, it is unclear why some of the material has been included. For example, paragraph A7 refers to 'data warehouses or report writers', without articulating how this information will inform the procedures to be undertaken on the audit. On the other hand, we feel there could be more guidance on the boundary of the IT environment where some services are run on cloud services or are outsourced.

- 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?**

We support separate assessments of inherent and control risk at the assertion level.

- 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?**

Although the concepts and definitions of inherent risk factors have the potential to enhance the identification of risks of material misstatements in theory, we are unclear on how these are intended to be applied in practice. While there is some useful guidance in the Application and Explanatory Material, we would expect to see greater reference to inherent risk factors in the requirements, for example how consideration of inherent risk factors could complement the auditor's understanding of the entity and its environment in accordance with paragraph 23(a).

- 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?**

The requirements and application material require the auditor to assess inherent risk by reference to likelihood and magnitude. However, a 'spectrum' indicates a single dimension. The IAASB does

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not explain how it intends practitioners to resolve the two dimensions of likelihood and magnitude into a single scale of inherent risk. Accordingly, we anticipate that practitioners will adopt a range of approaches to determine a spectrum, leading to inconsistent identification and assessment of risk. Further guidance on the documentation requirements in relation to likelihood and magnitude assessments and how are these linked to the spectrum of inherent risk would be helpful.

- 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 noticed that the term 'significant classes of transactions, account balances and disclosures' is used in the Introduction and is defined in paragraph 16(j) but the Requirements do not further elaborate. We would expect to see how to apply this central concept discussed more fully within the requirements of the standard.

- 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?**

The issues raised in our response to Question 6(c) also apply to the determination of significant risk.

If the IAASB intends that high magnitude, low likelihood risks should be assessed as significant risks, it could make this clear by adding an additional bullet point to paragraph A229.

- 7) 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 specific comments on this guidance.

- 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?**

With the introduction of a stand-back in paragraph 52, in our view the requirements of ISA 330.18 are no longer necessary. Therefore, we suggest removing paragraph 18 of ISA 330.

Conforming and Consequential Amendments

- 9) 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)?**

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- (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), are these appropriate and complete?**

We have no particular comments on this question.

- 10) Do you support the proposed revisions to paragraph 18 of ISA 330 to apply to classes of transactions, account balances or disclosures that are 'quantitatively or qualitatively material' to align with the scope of the proposed stand-back in ED-315?**

We have no particular comments on this question.

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.**

The complexity of language and structure make implementation difficult for English-speaking practitioners. Therefore it is expected that this complexity will also create challenges for translators.

- (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 think any consideration of the effective date will depend on the changes that are felt to be necessary following the consultation process. As noted above, we consider that extensive changes to structure and language are required to achieve the IAASB's objectives.