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Dan Montgomery
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, 10017
USA

On-line submission

Dear Dan

Submission on Exposure Draft ED-315 Identifying and Assessing the Risks of Material Misstatement

CPA Australia represents the diverse interests of more than 163,000 members working in 125 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

Overall CPA Australia supports the proposed auditing standard ISA 315 *Identifying and Assessing the Risks of Material Misstatement* as we consider that it will contribute to more effective risk assessment in practice, which is critical in underpinning quality audits. However, the complexity and length of the standard will inhibit scalability and may necessitate excessive documentation to justify why requirements may not be applicable for small or less complex entities. Structural enhancements may alleviate this problem to some extent, such as placing the minimum requirement for audits of smaller, less complex entities first and building on those base requirements for audits of larger and more complex entities. The meaning of the requirements could in many instances be stated more directly using plain English and the linkages between requirements expressed more directly.

We also note that some of the concepts introduced are confusing and may result in different interpretations, such as the definition of relevant assertions and significant risk, so would benefit from further clarification.

We suggest there is a need to reconsider or reengineer the way the suite of standards overall seek to communicate requirements and guidance with auditors. The flowcharts developed for this standard are a welcome step towards such a goal. Flowcharts or diagrams could be the basis or starting point for each standard and the requirements could be linked to explain each part of that flowchart rather than the reverse approach. Such depictions can really enhance understandability and direct the user's attention to specific requirements or application material which is relevant to them, as well as highlighting how each standard links to other standards.

Our responses to the consultation questions are set out in Appendix 1.

If you require further information on our views expressed in this submission, please contact Claire Grayston, Policy Adviser – Audit & Assurance, on +61 3 9606 5183 or at claire.grayston@cpaaustralia.com.au.

Yours sincerely

Craig Laughton
Executive General Manager Policy, Advocacy & Public Practice, Legal & Compliance

APPENDIX 1

Our responses to the consultation questions are set out below.

Overall Questions

1. **Has ED-315 been appropriately restructured, clarified and modernised 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)?

Whilst the requirements and application material in this ED are much more extensive than the extant standard, they do provide assistance in articulating what should be considered. However, we suggest that it would be helpful to state in the introduction or in the objective of the standard that the purpose of the risk assessment is to identify:

- risks of material misstatement at the financial statement level,
- significant risks,
- other assessed risks of material misstatement; and
- risks of material misstatement for which substantive procedures alone do not provide sufficient appropriate audit evidence

on which to base the audit response in ISA 330.

This is clear from the risk assessment flowchart, but is not easily understood from the requirements, partially because the standard is so voluminous.

We suggest that the section on identifying risk of material misstatement (ROMM) and assessing ROMM at the financial statement and assertion levels for inherent risk, paragraphs 45-49, should be placed before the evaluation of design and implementation of the entity's internal controls in paragraph 36, as controls design and implementation cannot be assessed without an understanding of the ROMM and controls relevant to the audit can only be determined based on assessed risks. Although the risk assessment process is iterative, as stated in paragraph 4 the identification of ROMM at the assertion level occurs before consideration of controls. This is logical as controls to address ROMM cannot be evaluated without first identifying the relevant assertions and the ROMM which they seek to address. The auditor may then identify specific controls that address the identified risks of material misstatement and for which the auditor intends to test operating effectiveness.

The flowcharts are beneficial, if not essential, in understanding how the standard flows and how the requirements interact and we recommend their publication along with the standard or as part of guidance material. We suggest that the risk assessment flowchart requires an amendment in relation to the stand back requirement. We consider that this step should only feed back into "identified risk of material misstatement at the assertion level" and not directly into the responses to ROMM. It would not be possible to respond to any matters identified by the stand back without assessing the inherent and control risks. In addition to the flowcharts, we note that the diagram in paragraph 52 of the explanatory memorandum is useful in depicting the assessments of inherent risk and control risk and should be included in the standard.

(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?

Yes, we consider that the greater detail and explanation of the risk assessment, understanding the entity and internal control, whilst challenging for small or less complex audits, will be beneficial for many audits especially medium to large entities with some level of complexity and will promote a more robust process.

We acknowledge that the ED has sought to address the public interest issues raised in the explanatory memorandum, which we support, and this has been achieved to a large extent in the ED, although the iterative nature of a risk assessment, scalability and data analytics continue to be challenges, which would benefit from further consideration as to how they could be addressed most effectively.

(c) Are the new introductory paragraphs helpful?

We welcome the introductory paragraphs which provide context and an overview of the approach within the standard. However, we suggest that the relevance “significant risks” and “risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence” needs to be addressed in the introduction and how the response to these will differ from “other assessed risks of material misstatements”. It would be helpful if this was covered in paragraph 7 and if paragraph 11 was removed as it does not put these risks into context.

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?

Whilst we acknowledge that the IAASB has sought to allow for scalability, the very size and complexity of the standard will make scaling it challenging. The approach taken in the ED is that it addresses more complex entities in the requirements and then in effectively scales back the work effort for less complex entities in the application material. We have a difficulty with this approach as we consider that a principles-based standard should really start with the basic requirements which apply to all entities and scale up the work effort for larger or more complex entities.

Given the way that this standard is structured, the auditor will need to consider all of the 38 paragraphs of requirements and 247 application paragraphs, in order to then assess the extent to which those apply to the entity that they are auditing. This means that auditors of smaller or less complex entities may have a significant amount of documentation to justify why requirements may not be relevant, rather than focusing on evidence to support their opinion. In an environment where audit regulators and professional bodies review audit engagements against the auditing standards this may create an unreasonable regulatory burden.

Scalability could also be facilitated by providing examples demonstrating sufficient procedures for a risk assessment for a small non-complex entity or contrasting risk assessment procedures for a complex and non-complex entity in the same sector.

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 welcome the incorporation of automated tools and techniques in the standard along with the examples provided. Although deeper consideration of how the risk assessment may be altered by the use of such techniques and the kind of techniques which may be useful in risk assessment could be explored, even if it is in separate guidance material.

Further application material may be helpful on the use of big data from sources outside of the entity's information system as well as information held within the entity which is outside of the management information and financial reporting systems, such as within email and document management systems.

4. Do the proposals sufficiently support the appropriate exercise of professional scepticism throughout the risk identification and assessment process?

Yes, the proposals have adequately incorporated the manner by which professional scepticism can be exercised in the risk assessment.

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 do not support the use of the term 'sufficient appropriate audit evidence' in this context. It is used in the suite of auditing standards to mean the audit evidence necessary to support the auditor's opinion and report on the financial report. That is not the relevant meaning in the risk assessment process. We do not consider that this encourages professional scepticism but instead may cause confusion regarding the intention of the requirement in paragraph 17. We recommend deleting this term from paragraph 17 so that it reads simply: "The auditor shall design and perform risk assessment procedures to obtain an understanding of (a)... (b) ...and (c)... as the basis for the identification and assessment of risk...". Including this term in relation to risk assessment does not encourage professional scepticism, but is simply at odds with the premise that risk assessment procedures alone do not provide sufficient appropriate audit evidence.

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?

Whilst the understanding of each internal control component has been enhanced, what to do with that understanding is not clear for each component, such as how that understanding links to testing of design and implementation. In addition, the relationship between the evaluation of the control components and the risk identification and assessment is not clear in the requirements, although it is touched on in application material (paragraph A201). It is difficult to follow the flow of the standard and how the different sections relate to one another, albeit that those relationships are complex and do not represent a step by step process. We suggest further consideration of the outcomes the auditor is seeking under each section of the standard and then making sure that those are clearly articulated.

We suggest that the following specific matters are considered:

- Some of the requirements in paragraph 27 will be difficult to apply, in that they are very difficult to test or document adequately and may be better placed in application material. For example, the understanding of the control environment required includes how the entity "demonstrates commitment to integrity and ethical values" as well as "a commitment to attract, develop and retain competent individuals in alignment to its objectives". In addition, we suggest that this paragraph should be worded "whether" rather than "how" as indeed the entity may not be able to demonstrate that they do the things listed in that paragraph.

- Paragraphs 30 and 31 seem to relate to ways by which the auditor may assess whether the entity's risk assessment process is designed and implemented effectively, but does not articulate this.
 - Paragraphs 32-34 require an understanding of the entity's process to monitor the system of internal control but do not explain what to do with that understanding. There is no requirement for the monitoring controls be tested for design and implementation and yet it is not clear how these can be relied on without doing that testing.
 - Paragraphs 36 could be expressed in a similar way to paragraph 38 to cover understanding, design and implementation of the information and communication, before providing the detail in paragraph 35 and 37 about how that understanding may be obtained. It is somewhat confusing currently.
- (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?**

Yes, paragraph 39 clarifies controls relevant to the audit. However, we suggest that sub-paragraph 39(e) is deleted as design and implementation will need to be conducted as part of identifying the relevant controls and is not a reason for them to be relevant. The last part of sub-paragraph 39(e) is effectively a definition of controls relevant to the financial report and controls relevant to the audit, which we suggest is included in a separate paragraph before paragraph 39 and further explained.

The requirements do not allow for the auditor to obtain an understanding of the control environment and on that basis to decide not to rely on controls and conduct a substantive audit. Instead the auditor is still required to obtain an understanding of all of the other components of internal control regardless of any decision on whether to rely on controls. The option of doing a substantive audit, even that is in relation to specific transactions or balances, should be incorporated into the standard to avoid excessive audit effort and documentation, particularly for audits of small 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?**

Yes, we support the introduction of IT-related concepts and definitions.

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 the separation of the risk assessment for inherent and control risks, as controls should be designed to mitigate inherent risks and the procedures to assess control risk are quite different to inherent risk. However, clarity regarding whether ROMM is based on inherent and control risk would be helpful, as the controls are designed to address the ROMM.

- (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?**

Yes, the inherent risk factors are helpful to focus the risk assessment on matters which will cause higher risk.

- (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 spectrum of risk is useful in understanding the impact of the magnitude and likelihood of material misstatement arising from the identified risks, however it does not necessarily help to identify the cut-off for significant risks, albeit that this may be a matter of professional judgement.

- (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?**

The definition of relevant assertions uses the phrase “more than remote” as having the same meaning as “reasonable possibility of occurrence” in relation to the likelihood of misstatements, although in our view, based on a plain English understanding of these phrases, they are not equivalent. We recommend avoiding use of the phrase “more than remote” as it suggests a very low bar for relevant assertions and would categorise potentially the large majority of assertions as relevant.

- (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 definition of “significant risk” links it to the likelihood or magnitude of potential misstatement, however this suggests that the size of the balance or transaction alone could lead to significant risk. Whereas we suggest that it should be the combination of likelihood and magnitude which will determine significant risk.

- 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?**

The requirement in paragraph 47 is somewhat circular in that it focusses on the impact on risks at the assertion level and on the responses to assessed risk under ISA 330. This doesn’t provide clarity about how risks at the financial statement level are actually determined without pre-empting how those risks will influence these other matters.

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

We support the stand back provision as it considers the materiality of the balances, transactions and disclosures but does not require them to be tested if it is not necessary, however we consider that the requirement in ISA 330 paragraph 18 undermines this requirement. ISA 330 effectively requires all quantitatively and qualitatively material balances, transactions and disclosures to be subject to substantive procedures, which means the stand back provision would be obsolete. We suggest only one of these requirements is needed not both and would support paragraph 52 of ED-315 as being sufficient.

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)?**

Yes, no concerns noted.

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

Yes, except that as noted in question 8 above we suggest that ISA 330 paragraph 18 is removed as it is inconsistent with the stand back provision.

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

Yes, no concerns noted.

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

Yes, no concerns noted.

- 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?**

As suggested in question 8 above we do not think this amendment goes far enough as is inconsistent with the stand back provision in this ED and this paragraph should be removed.

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-recognising that many respondents may intent to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-315.**

No comment.

- (b) Effective Date-Recognising 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 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 agree that 18 months after approval should be sufficient time for effective implementation.