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Dan Montgomery — Interim Technical Director
International Auditing and Assurance Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017

Dear Mr. Montgomery:

Deloitte Touche Tohmatsu Limited (DTTL) (also referred to as Deloitte Global) is pleased to have the opportunity to provide comments on the Exposure Draft, proposed International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement and Proposed Consequential and Conforming Amendments to Other ISAs* ("ED-315" or the "proposed standard") issued by the International Auditing and Assurance Standards Board ("IAASB" or the "Board") in July 2018.

DTTL appreciates and commends the IAASB's substantial efforts in the development of ED-315, and the Board's solicitation of input from regulators and other key stakeholders which, DTTL believes, were instrumental in providing the appropriate direction and input for the project. DTTL commends the Board for the significant improvements made to ED-315. DTTL acknowledges that the risk assessment process is foundational to an audit of financial statements and believes that the fundamental approach taken in ED-315 to enhance and expand the requirements and guidance pertaining to the identification and assessment of the risks of material misstatement, as well as the related auditor's work effort, will increase audit quality and the effectiveness of the auditor's risk assessment process.

Impact on audit quality

DTTL believes that the direction taken by the IAASB in ED-315 provides for a revitalized process to identify and assess risks of material misstatement, supporting the continued efforts of the profession to improve the quality of the risk assessment process for all audits. Targeting the auditor's work efforts on the risk assessment process, in particular focusing the auditor's attention on identifying risks based on the understanding of the entity and its system of internal control, is the appropriate way forward.

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DTTL notes that challenges pertaining to the risk assessment process cannot be resolved via the standard-setting process alone. Appropriate execution by auditors of the requirements in the standards, taking into account the specific facts and circumstances relevant to the engagement, is equally important. It is the opinion of DTTL that tangible improvements in audit quality are most readily realizable when the auditing standards provide for clear, executable requirements that are capable of being understood and operationalized.

DTTL believes that the following areas within the proposed standard are instrumental in continuing to enhance audit quality in the risk assessment process:

Separation of the assessment of inherent risk and control risk

The separate assessment of inherent risk and control risk allows for a more granular risk assessment. DTTL believes that it is imperative that the control risk be evaluated separately from the inherent risk for each risk of material misstatement at the assertion level due to the intrinsic differences in these two types of risk. While DTTL strongly believes that these elements should be separated, additional guidance within the proposed standard is needed to support the consistent interpretation by auditors and other users of the standards **(see response to question 6a in Appendix I)**.

Introduction of IT concepts

The introduction of IT concepts within ED-315 is a significant improvement to the proposed standard. Entities in today's environment are heavily reliant on IT systems. The required understanding of an entity's IT systems provides for the needed modernization of the proposed standard and will result in a better and more thorough risk assessment **(see response to question 5c in Appendix I)**.

Inclusion of automated tools and techniques

The inclusion of automated tools and techniques within ED-315 has modernized the proposed standard to better reflect the risk assessment procedures being performed by auditors today, and in the future. DTTL believes that the advancement of automated tools and techniques will continue to improve the auditor's ability to perform a more thorough and thoughtful fact-based risk assessment and as a result, will support audit quality. DTTL supports the Board's focus on the relevance of ED-315 for today's audit as well as the audit of the future. DTTL encourages the Board to continue to consider if additional guidance is needed to support the incorporation of automated tools and techniques, such as guidance around the use of data within automated tools and techniques **(see response to question 3 in Appendix I)**.

Risk assessment process

DTTL commends the Board on the significant improvements made in ED-315 around the risk assessment process but believes that there are key issues that require additional focus from the Board which have been specifically highlighted below. In addition, provided below are detailed responses to the questions posed within ED-315 in **Appendix I**.

Consideration of fraud

The consideration of fraud in the risk assessment process is important as it helps auditors identify fraud risk factors that may be present and may lead to the identification of risks of material misstatement related to fraud. As such, DTTL is supportive of the inclusion of the

consideration of fraud within ED-315. DTTL believes that this is best achieved through the inclusion of references within the proposed standard to ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* (ISA 240). DTTL is not supportive of the inclusion of management bias or fraud as an inherent risk factor as included in the definition within paragraph 16(f) of ED-315. DTTL believes that inherent risk is evaluated first, followed by a separate evaluation of the risk of fraud in accordance with ISA 240; i.e., inherent risks are first identified, and then evaluated as to whether they are risks of material misstatement due to fraud or due to error.

For example, consider the valuation of goodwill. When evaluating the inherent risk factors for valuation of goodwill, an auditor may identify one or more risks of material misstatement at the assertion level due to the higher level of subjectivity and complexity that exists in the valuation process. Given the nature of these risks, it is typically more likely that the valuation of goodwill may also be susceptible to misstatement due to management bias or fraud; however, management bias or fraud is **not** the event or condition that gave rise to the risks of material misstatement related to the valuation of goodwill.

DTTL therefore strongly believes that the board should remove "management bias or fraud" from the list of inherent risk factors. The proposed standard could, however, continue to place the necessary emphasis on fraud-related considerations by making the linkage to ISA 240 even more prominent; i.e., to address potential concerns that fraud related matters are not sufficiently prominent. To the extent that the Board does not revise the proposed standard, to exclude management bias or fraud from the list of inherent risk factors, DTTL believes that additional application guidance needs to be provided on how the other inherent risk factors are meant to interact with the management bias or fraud risk factor and how ISA 315 is intended to interact with ISA 240 (**see responses to questions 6b and 9a in Appendix I**).

Definition of significant risk

The definition of significant risk does not align with the definition of relevant assertion within paragraph 16(h). Paragraph 16(h) outlines that an assertion is relevant to a class of transaction, account balance, or disclosure when the nature or circumstances of that item are such that there is a **reasonable possibility of occurrence of a misstatement with respect to that assertion that is material** individually or in combination with other misstatements; this therefore indicates that risk should be based on likelihood **and** magnitude. In order to align the definitions, DTTL's view is that significant risk should be defined as an identified risk of material misstatement for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which one or a combination of inherent risk factors affect the likelihood of a misstatement occurring **and** the magnitude of potential misstatement, should that misstatement occur (**see response to question 6e in Appendix I**).

Stand-back requirement

The proposed standard is based on a thorough understanding of the entity and its system of internal control after which the auditor identifies and assesses the risks of material misstatement. The requirements and guidance in ED-315 drive a robust, risk-based approach that allows the auditor to better tailor procedures based on the reasons for the assessed risks of material misstatement. The robust risk assessment procedures within ED-315 also enable the auditor to identify the classes of transactions, account balances and disclosures for which no reasonable possibility of material misstatement exists. The inclusion of the stand-back requirement in paragraph 52 of ED-315 for classes of transactions, account balances and

disclosures that are quantitatively or qualitatively material that have not been identified as significant does not appear to be directly aligned with the risk-based approach taken in the proposed standard; DTTL believes this stand-back should be removed. DTTL believes that the stand-back requirement will result in additional focus on classes of transactions, account balances and disclosures that were already determined by the auditor not to be qualitatively or quantitatively material through the risk assessment process, with no measurable increase in audit quality. The inclusion of the stand-back requirement also adds additional unneeded complexity to the proposed standard. Finally, the iterative nature of the proposed standard which requires that the auditor reassess the risk assessment conclusions reached (e.g., as new information is obtained that may inform or contradict previous conclusions), making the stand-back requirement unnecessary (i.e., because that auditor has been re-assessing, and “standing back” throughout the process).

In addition to the stand-back requirement in ED-315, ISA 330.18 requires the auditor to focus again on the same population of classes of transactions, account balances and disclosures through performance of substantive procedures, irrespective of whether there are risks of material misstatement. As a result, the stand-back in ED-315 is duplicative of the requirements in ISA 330.18 **(see responses to questions 8 and 10 in Appendix I)**.

Scalability

DTTL acknowledges the IAASB’s commitment to including scalability within ED-315 and is supportive of the guidance included throughout the proposed standard. DTTL would encourage the IAASB to develop additional specific non-authoritative guidance for smaller and less complex entities to support the implementation of ED-315 consistent with the IAASB’s project proposal **(see response to question 2 in Appendix I)**.

Conclusion

DTTL is supportive of the work on ED-315 that the IAASB has undertaken. DTTL believes that aspects of ED-315 should be revisited to clarify the risk assessment and work effort to be performed by the auditor. DTTL believes that the comments articulated in this letter will assist the IAASB as it continues its deliberations.

DTTL’s comments on ED-315 are addressed as follows:

- Appendix I.** Response to requests for specific comments
- Appendix II.** Editorial comments and other recommendations

DTTL appreciates the opportunity to provide perspectives on ED-315 and would be pleased to discuss this letter with you or your staff at your convenience. If you have any questions, please contact me via email (cbuss@deloitte.ca) or at +1 604 640 3313.

Very truly yours,

A handwritten signature in black ink, appearing to read "Calvin H. Buss". The signature is fluid and cursive, with the first name "Calvin" and last name "Buss" clearly distinguishable.

Calvin H. Buss, FCPA, FCA
Senior Managing Director, Global Audit & Assurance Quality Leader
Deloitte Touche Tohmatsu Limited

APPENDIX I

RESPONSE TO REQUESTS FOR SPECIFIC COMMENTS

DTTL's responses to the detailed questions included in the IAASB's Explanatory Memorandum accompanying the proposed standard are set forth in this appendix. In these comments, recommended additional text is shown using **bold underline**; recommended deletions to the text are shown using double ~~strike through~~.

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)?

DTTL agrees that the proposed changes help with the understandability of the risk identification and assessment process. However, due to the length and complexity of the proposed standard, DTTL believes that the flowcharts are helpful to the understanding of the requirements within the proposed standard. While there are some comments on the flowcharts included in this letter, DTTL recommends that the flowcharts be released as non-authoritative guidance (which then allows for further refinement and updating, as needed in the future).

(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?

DTTL is supportive of the changes made to the proposed standard, with the exceptions noted within this letter. DTTL believes that with consideration of the feedback included within this comment letter, the proposed standard will provide a more robust identification and assessment of risks.

(c) Are the new introductory paragraphs helpful?

DTTL is supportive of the inclusion of the introductory paragraphs and the context that they provide to the proposed standard.

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?

The response in this area should be read in conjunction with DTTL's comments on *Scalability* in the cover letter. Due to the complexity of the proposed standard, DTTL believes that additional non-authoritative guidance for smaller and less complex entities

to support the implementation of ED-315 consistent with the IAASB's project proposal should be provided. DTTL believes that the complexity of the proposed standard may inherently cause challenges for scalability. As such, DTTL believes that identification and assessment of risks of material misstatement for smaller and less complex entities should be evaluated by the IAASB when developing the discussion paper on *Exploring Possible Actions for Dealing with the Perceived Challenges of Conducting Audits of Less Complex Entities*.

- 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?**

As discussed in our cover letter, DTTL believes that the inclusion in the proposed standard of automated tools and techniques, including data analytics and visualization techniques, was fundamental in updating the proposed standard to correspond with the technology used in audits today and in the future. DTTL believes that the use of such tools, if available to the auditor and appropriate in the circumstances, is critical in supporting a fact-based risk assessment. Finally, DTTL believes that it is important that the inclusion of automated tools and techniques be incorporated through examples rather than requirements, as tools and techniques may not be available to all auditors and DTTL does not believe that the board intends to inadvertently create barriers to audit innovation.

DTTL believes that additional enhancements should be considered to the ISA standards regarding the use of automated tools and techniques. Specifically, the Board should consider if guidance is needed on procedures the auditor should perform relating to data that is being utilized in automated tools and techniques to evaluate its reliability, such as procedures around obtaining data, the preparation of data and the evaluation of the output of the automated tool or techniques. DTTL believes that this guidance could be incorporated into the IAASB's project on ISA 500, *Audit Evidence*, either as part of a revision to the proposed standard or through non-authoritative guidance.

- 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' 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?**

DTTL believes that the more robust requirements and appropriately detailed guidance for the risk assessment process in ED-315 provides for a better basis to develop effective audit responses. This emphasis on risk assessment in turn reinforces the underlying concept of being professionally skeptical.

- 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?**

DTTL is supportive of the enhanced requirements and related guidance on obtaining an understanding of the entity's system of internal control to inform the risk identification and assessment process. DTTL believes that obtaining an understanding of the entity's system of internal control, including the IT environment, is essential to the risk assessment process due to the significant use of technology by entities. DTTL believes that the proposed standard outlines why the understanding of an entity's system of internal control is obtained and how the auditor's understanding of the entity's system of internal control informs the risk identification and assessment process. In addition, as stated in response to **question 2** above, DTTL believes that additional non-authoritative guidance is needed to support smaller and less complex entities. Due to the changes in the proposed standard on understanding of the entity's system of internal control, DTTL believes that this area should be included in any non-authoritative guidance developed by the IAASB for smaller and less complex entities.

- (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?**

While the identification of relevant controls to the audit has been enhanced within ED-315, DTTL believes that the proposed standard should provide further clarification on two areas.

First, further guidance should be provided on paragraph 39(e)(i) to assist auditors in identifying scenarios in which controls would be required to be identified in order to "identify and assess the risks of material misstatement at the assertion level." DTTL believes adding additional examples to A179 to address 39(e)(i) is essential in helping auditors understand when such controls are relevant to the audit.

In addition, "indirect controls" are discussed within the application guidance; however, the proposed standard does not clearly address when indirect controls should be identified as controls relevant to the audit. The IAASB should expand the proposed standard, including consideration of application material, to address when indirect controls should be identified as relevant to the audit.

- (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?**

DTTL agrees with the inclusion of the new IT-related concepts and definitions. Specifically, DTTL believes that the four criteria to determine IT application relevancy, combined with clarifications on identifying risks arising from IT and the general IT controls to address them, and the need to evaluate design and implementation of said controls only if IT applications are determined to be relevant, represent significant enhancements to the proposed standard that will result in substantial improvements in the risk assessment process.

DTTL would encourage the Board to consider additional expansion of IT content regarding assessing the risks arising from IT and varying the nature, timing and extent of general IT control testing based on those risk assessments. In addition, the Board should consider providing non-authoritative guidance on typical general IT controls to address relevant risks arising from IT described by the IT layer (e.g., application, database, operating system and network).

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?

As noted in the cover letter and as previously addressed by the Board in ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* (ISA 540), DTTL believes that the separate assessment of inherent risk and control risk in relation to all risks of material misstatement at the assertion level provides for a more robust risk assessment that will positively impact audit quality. DTTL believes that the "ISA 315 (Revised) Identifying and Assessing Risks of Material Misstatement" flowchart supports the understanding of the separate assessment of inherent risk and control risk. DTTL believes that it is imperative that auditors understand this fundamental change in the risk assessment process. To support this understanding, additional non-authoritative guidance, in addition to the flowcharts, should be provided to assist auditors that are implementing the concept for the first time.

While DTTL supports the separate assessment of inherent risk, DTTL believes that paragraph 48 of the proposed standard needs to be re-evaluated. The paragraph states that for identified risks of material misstatement at the assertion level the auditor should assess inherent risk; however, paragraph 14 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, states that risk of material misstatement is based on inherent and control risk. As such, the proposed standard appears to indicate that inherent risk is required to be evaluated twice. DTTL notes that the same issue is present in the "ISA 315 (Revised) Identifying and Assessing Risks of Material Misstatement" flowchart as it indicates that risks of material misstatement are identified first and then separately inherent risk is assessed for risks of material misstatement at the assertion level. DTTL believes that inherent risk is assessed when determining if a risk of material misstatement exists at the financial statement level and

the assertion level. However, DTTL acknowledges that risk assessment is an iterative process, and that often (e.g., in a recurring audit) the auditor may already have an idea or preliminary conclusion as to whether risks of material misstatement exist. The iterative nature of risk assessment is not sufficiently addressed and may lead to viewing risk assessment as a linear process (e.g., the flowcharts imply that risk assessment is linear and that there is a strict order in which risk assessment always occurs).

(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?

The response in this area should be read in conjunction with DTTL's comments on *Consideration of Fraud* in our cover letter. DTTL does not support the inclusion of "management bias or fraud" as an inherent risk factor as it is not "inherent" in classes of transactions, account balances, or disclosures; rather, it is a result of an opportunity created by the presence of complexity, subjectivity, change, or uncertainty as stated within A84 of the proposed standard. As such, DTTL believes that ED-315 should be revised to remove management bias or fraud as an inherent risk factor and instead provide guidance on (1) how the inherent risk factors (complexity, subjectivity, change and uncertainty) can result in the susceptibility of the class of transaction, account balance, or disclosure to management bias or fraud and (2) on the linkage to ISA 240 paragraph 24 to evaluate if a fraud risk factor is present.

To the extent that the Board does not revise the listing of inherent risk factors to remove "management bias or fraud" as a qualitative risk factor, DTTL believes that additional application guidance needs to be provided on how to evaluate management bias and fraud as part of inherent risk and, if management bias and fraud are considered as part of the inherent risk factors, how inherent risk interplays with fraud risk factors and the identification of significant risk. For example, additional guidance should be provided regarding if fraud is inherent for a class of transaction, account balance, or disclosure that it would need to be classified as a significant risk in accordance with ISA 240 **(see additional comments within comment 9a below)**.

(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?

DTTL is supportive of the concept of spectrum of inherent risk but believes that "spectrum of inherent risk" should be a defined term within the proposed standard. Currently, the proposed standard does not have the necessary clarity on what the spectrum of inherent risk should be based on. For example, it could be interpreted that the spectrum should be engagement-specific such that any risk that is on the higher end of the spectrum for that individual engagement would be a significant risk, which would result in auditors always having to identify significant risks. This interpretation would indicate that all audits are required to have significant risks, which is not

currently a requirement within the ISAs. The definition of “spectrum of inherent risk” should therefore clarify that the spectrum is not meant to be audit engagement-specific but instead is a general scale to be used broadly. In addition, the Board should consider adding examples to the application guidance to support the consistent interpretation of the proposed standard in this regard.

(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?

DTTL is supportive of the definitions of significant classes of transactions, account balances and disclosures and their relevant assertions and believe they assist the auditor in identifying where the risks of material misstatement exist.

DTTL believes that paragraph 46 of the proposed standard should be reconsidered as it implies that the auditor must first identify risks of material misstatements before identifying significant classes of transactions, account balances and disclosures. DTTL believes that the proposed standard should be nonlinear. For example, an auditor may determine which accounts are significant based on a preliminary determination of the risks of material misstatement, and may then confirm the identification by going through the formal process to identify the risks of material misstatement. Currently, the proposed standard appears to always require the identification of the risks of material misstatement prior to the identification of significant accounts. DTTL suggests the following revision to paragraph 46 to enhance the proposed standard:

46. The auditor shall determine significant classes of transactions, account balances and disclosures, and their relevant assertions, ~~based on~~ **considering** the identified risks of material misstatement **and the risk assessment procedures performed.**

In addition, the flowchart should make it clear that the risk assessment process is an iterative process, and is not linear. DTTL would suggest revising the flowchart to show more dynamic interaction between the identification of significant accounts and the identification of risks of material misstatement. In addition, DTTL believes that the “Notes” at the bottom of the page should be revised to note that the process is not required to be linear, as the flowchart describes.

(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 response in this area should be read in conjunction with DTTL's comments on the *Definition of significant risk* in our cover letter. DTTL believes that the following changes should be made to the definition of significant risk:

16. (k) Significant risk – An identified risk of material misstatement:

- For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which one or a combination of inherent risk factors affect the likelihood of a misstatement occurring **and** ~~or~~ the magnitude of potential misstatement should that misstatement occur; or
- That is to be treated as a significant risk in accordance with the requirements of other ISAs.

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?

DTTL agrees with the guidance on risks of material misstatement at the financial statement level; however, the guidance is currently in various paragraphs throughout the proposed standard. DTTL believes that the guidance could be better organized to more clearly articulate the proposed standard by consolidating where the guidance is located.

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?

The response in this area should be read in conjunction with DTTL's comments on the stand-back requirement in our cover letter and the response to question 10 below. DTTL believes that the stand-back requirement does not align with the concepts within the proposed standard and adds unneeded complexity. If an auditor is applying the concepts within ED-315, an appropriately detailed risk assessment will be the result, which negates, or makes redundant, the need for the stand-back requirement. As such, DTTL believes that the stand-back requirement should be removed from the proposed standard.

In addition, DTTL believes that the requirements in paragraph 18 of ISA 330 should be removed. As stated above, if the procedures within ED-315 have been appropriately applied to identify risks of material misstatements, the action of performing substantive procedures over class of transaction, account balance and disclosure which have not been identified as significant (and therefore for which no risks of material misstatement have been identified) but that are qualitatively and quantitatively material, results in 1) audit procedures performed for accounts that do not have a risk of material misstatement and 2) additional audit procedures being performed that do not increase the quality of the audit.

Further, DTTL believes that the IAASB needs to consider how these requirements will impact the proposed standard in the future, given the continual advancement in risk

assessment procedures as the result of the implementation of automated tools and techniques. With automated tools and techniques, the auditor will be better equipped to identify when risks or risk factors do not rise to the level of a risk of material misstatement. The proposed standard currently does not allow for risk assessment conclusions to stand on their own when the class of transaction, account balance and disclosure is qualitatively or quantitatively material. Rather, paragraph 52 of ED-315 and paragraph 18 of ISA 330 undermines and second-guesses the professional judgments and conclusions the auditor has made and thus does not support such advanced risk assessment procedures.

In addition, ED-315 requires the auditor to have sufficient, appropriate audit evidence related to their risk assessment. DTTL believes that the requirement for sufficient appropriate audit evidence eliminates the need for the stand-back requirement as the auditor is required by the proposed standard to have supported the judgements made during the risk assessment process, i.e., in order to be able to conclude that sufficient appropriate audit evidence has been obtained.

However, if the IAASB believes that ISA 330 paragraph 18 is needed in order to deal with the situation that only tests of controls have been performed for significant accounts (i.e., to require some level of substantive testing), DTTL would encourage the Board to consider providing additional clarification on the purpose of paragraph 18 (or revise other requirements) within ISA 330 through amendments to ISA 330.

To the extent that the stand-back requirement is retained, DTTL believes that it is necessary to remove "qualitatively" from paragraph 52(a) in ED-315. In DTTL's experience, classes of transactions, account balances and disclosures that are considered qualitatively material in nature are identified as part of the risk assessment process and would have an associated risk of material misstatement, i.e., based on the qualitative considerations. As such, there would be no population of class of transactions, account balances and disclosures that would be qualitatively material to assess as part of the stand-back requirement. The following edit should be made to the proposed standard if the stand-back requirement is retained:

52(a) Identify the classes of transactions, account balances and disclosures that are quantitatively ~~or qualitatively~~ material, and that have not been identified as significant classes of transactions, account balances or disclosures in accordance with paragraph 46; and

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)?

DTTL is supportive of the changes made to ISA 200 and ISA 240 to reflect the changes in the proposed standard. As discussed in the cover letter and in question 6(b) above, DTTL believes that the consideration of fraud within ED-315 should be re-evaluated. To the extent that no further changes are made in response to the comments around management bias and fraud as an inherent risk factor, the IAASB should clarify the interaction between the evaluation of management bias and fraud as part of determining inherent risk in ED-315 and the evaluation of fraud risk factors within ISA 240.

(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?

DTTL is supportive of the changes included in paragraphs A29a and A30, which draw linkage to data, reports and substantive procedures alone being drivers for IT application and general IT control relevancy and paragraph A29b, which provides guidance on how the auditor can complete additional procedures to determine if an IT risk has been exploited or identify and test appropriate alternate controls if a deficiency exists in general IT controls. See responses to questions 8 and 10 for comments on ISA 330 paragraph 18.

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

DTTL agrees that the other ISAs presented in Appendix 2 are appropriate.

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

DTTL concurs that ISA 540 (Revised) and related conforming amendments are appropriate.

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?

This response should be read in conjunction with the comment letter and the response to question 8 above. As noted above, DTTL believes that paragraph 18 of ISA 330 should be deleted as there are various instances where a class of transactions, account balance and disclosure is material but determined through appropriate risk assessment to have no reasonable possibility of material misstatement. For example, goodwill may be a quantitatively material balance; however, based on a thorough understanding of the entity, the auditor may appropriately determine that there is not a reasonable possibility of material misstatement related to goodwill due to various factors (e.g., no changes in the business, no changes in the industry, strong financial performance, history of significant excess in value in use over the carrying value). In this example, under the proposed standard the auditor would be required to perform substantive audit procedures, i.e., even though a thoughtful and thorough risk assessment resulted in the conclusion that there are no risks of material misstatement related to goodwill. The substantive procedures performed by the auditor in this example would not be addressing any identified risk of material misstatement. Requiring substantive procedures for each class of transactions, account balance and disclosure where there is no reasonable possibility of material misstatement results in procedures that are inadequately tailored and unnecessary.

If ISA 330 paragraph 18 is not removed, the Board should however consider removing "qualitatively" material from the paragraph. Classes of transactions, account balances and disclosures that are qualitatively material in nature are identified as part of the risk assessment process and would have an associated risk

of material misstatement identified as part of the process required in ED-315. As all class of transactions, account balances and disclosures that are qualitatively material would already have an identified risk of material misstatement there would be no population of class of transactions, account balances and disclosures that would be qualitatively material to perform substantive procedures in order to address the requirement in ISA 330 paragraph 18. If ISA 330 paragraph 18 is retained, DTTL would suggest the edit below:

ISA 330 18. Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each class of transactions, account balance, and disclosure that is quantitatively ~~or~~ qualitatively material.

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.**

DTTL would recommend that the IAASB eliminate redundancies and repetitive phrases to ensure that the intention of the requirements and the related application material will not be missed in translation. DTTL has included certain suggestions within the listing of editorial comments in **Appendix II**.

- (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.**

As the proposed standard is focused on risk assessment, which requires the auditor to make changes early in the audit process, DTTL is supportive of an effective date for financial reporting periods beginning approximately 18 months after the approval of a final ISA. DTTL would however also support the ability to early adopt the proposed standard, especially given its interaction with ISA 540 (Revised) which would already be effective when this final standard is approved.

Other areas

Requirement for evaluating design of controls for GITC controls versus non-GITC controls

DTTL notes that in paragraph 36 of the proposed standard there is a requirement for the auditor to evaluate the design of the information system controls relevant to financial reporting, however, there is no consistent requirement for controls relevant to the audit as described in paragraph 39. DTTL would encourage the board to align the language or clarify the differences in the requirements for information system controls.

The entity's process to monitor the system of internal control

DTTL believes that the following should be removed from paragraph 32 as DTTL believes that it is not necessary to separately call out the entity's risk assessment process within the paragraph on the entity's process to monitor their system of internal control. The entities risk assessment process would inherently be included as part of their system of internal control. DTTL would suggest the following revision to accomplish this change:

32. The auditor shall obtain an understanding of the entity's process to monitor the system of internal control, including the extent to which it is formalized, by understanding how the entity's process:

- (a) Monitors the effectiveness of controls; and
- (b) Addresses the identification and remediation of control deficiencies, ~~including those related to the entity's risk assessment process~~

Risks for which substantive procedures alone do not provide sufficient audit evidence

As technology utilized by entities continues to evolve, DTTL believes that it is important that additional application material be provided including more examples relating to risks for which substantive procedures alone do not provide sufficient audit evidence.

Public Sector

Paragraph A24 is written as a consideration specific to public sector entities; however, DTTL believes that this paragraph as written is applicable to all entities. DTTL would encourage the Board to consider if this guidance should be revised to clarify why it is applicable only to public sector or be removed.

APPENDIX II

EDITORIAL COMMENTS AND OTHER RECOMMENDATIONS

DTTL has editorial comments and other recommendations with respect to ED-315 as set forth below. In these comments, recommended additional text is shown using **bold underline**; recommended deletions to the text are shown using double ~~strike through~~.

ED-315 Paragraph number	Editorial comments and other recommendations
Contents page	Obtaining an understanding of the entity and its <u>its</u> environment and the applicable financial reporting framework
45	<p>Remove reference to inherent risk factors as it is repetitive with paragraph 48. In addition, the related application material in paragraph A208 would be better in relation to paragraph 48, as this is where the consideration of inherent risk is more fulsomely discussed.</p> <p>The auditor shall identify the risks of material misstatement and determine whether they exist at:</p> <ul style="list-style-type: none">(a) The financial statement level, by evaluating whether the identified risks relate more pervasively to the financial statements as a whole, including potentially affecting many assertions; or(b) The assertion level for classes of transactions, account balances, and disclosures, taking in to account the inherent risk factors
A179	<p>Modification to the last bullet of A179 to clarify wording.</p> <p>The identification of risks of material misstatement and the related assessments of inherent risk at the assertion level because ISA 330 requires more persuasive audit evidence the higher the auditor's assessment of risk. For risks that are assessed as higher <u>on the spectrum of inherent risk</u>, but are not significant risks, the auditor may identify controls over those risks to be relevant to the audit. Similar to controls over significant risks, the auditor's evaluation of the design of these controls and determination of whether they have been implemented contributes to the audit evidence related to the higher risk. This understanding of controls may also assist the auditor in designing further audit procedures responsive to the risk.</p>

ISA-200 Paragraph number	Editorial comments and other recommendations
A40	<p>Clarify the wording as currently drafted and eliminate duplication of phrases.</p> <p>Inherent risk is influenced by characteristics of events or conditions that affect the susceptibility to misstatement of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls (i.e. inherent risk factors). Depending on the extent to which the assertion is subject to, or affected by, such inherent risk factors, the level of inherent risk varies along the spectrum of inherent risk. The auditor determines significant classes of transactions, account balances and disclosures, and their relevant assertions, as part of the process of identifying and assessing the risks of material misstatement. For example, account balances consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty may be identified as significant account balances, and the auditor's assessment of inherent risk for the related risks at the assertion level <u>for significant account balances derived from accounting estimates that are subject to significant estimation uncertainty</u> may be higher because of high estimation uncertainty. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.</p>
ISA-240 Paragraph number	Editorial comments and other recommendations
44	<p>Clarify the wording as currently drafted.</p> <p>The auditor shall include the following in the audit documentation of the <u>auditor's</u> identification and the assessment of the risks of material misstatement required by ISA 315 (Revised):</p> <p>(a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud;</p>

- (b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level; and
- (c) Controls identified to be relevant to the audit because they address assessed risks of material misstatement due to fraud.

A25

Clarify the wording as currently drafted.

Fraud risk factors related to incentives, pressures or opportunities may arise from conditions that create susceptibility to misstatements due to management bias or fraud (which is an inherent risk factor). Alternatively, fraud risk factors may relate to conditions within the entity's system of internal control that provide opportunity to commit fraud or that may affect management's attitude or ability to rationalize fraudulent actions. **Fraud** risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information through, for example, the required understanding of the entity's control environment. Although the fraud risk factors described in Appendix 1 cover a broad range of situations that may be faced by auditors, they are only examples and other risk factors may exist.

A32

Clarify the wording as currently drafted.

It is therefore important for the auditor to obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud. In identifying the controls relevant to the audit that address the risks of material misstatement due to fraud, the auditor may learn, for example that management has consciously chosen to accept the risks associated with a lack of segregation of duties. Information from identifying the ~~these~~ controls **management has designed, implemented and maintained to prevent and detect fraud**, and evaluating their design and determining whether they have been implemented, may also be useful in identifying fraud risk factors that may affect the auditor's assessment of risks that the financial statements may contain material misstatement due to fraud.

ISA-330**Editorial comments and other recommendations**

Paragraph number

A1

Modification to the last bullet of paragraph A1 to remove the reference to risk of material misstatement, which is at the assertion level, as the paragraph is addressing risks of material misstatement at the financial statement level.

- The nature, timing and extent of substantive procedures. For example, it may be appropriate to perform substantive procedures at or near the date of the financial statements ~~when the risk of material misstatement is assessed as higher.~~