

November 1, 2018

Prof. Arnold Schilder
Chair
International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor
New York, NY 10017

Re: Exposure Draft / ISA 315 – Identifying and Assessing the Risks of Material Misstatement

Dear Prof. Schilder,

I appreciate the opportunity to provide my comments on the Proposed Draft Amendment to ISA 315 in IAASB's Exposure Draft – Identifying and Assessing the Risks of Material Misstatement and Proposed Consequential and Conforming Amendments to Other ISAs. My comments are as follows:

General Comments:

The Board's proposal to clarify and improve certain aspects of identification and assessment of risks of material misstatement, to better discern risk probabilities, will enhance audit quality. By flowcharting the process to identify risks of material misstatement at two levels, the resulting basic audit structural framework will assist in developing a robust audit plan. Additionally, by providing a three-dimensional plan to develop and understand the overall audit approach for the entity, the entity's internal control system and the IT environment, other stakeholders will also develop an appreciation for the quality of audit processes.

Specific Comments:

Question 1

Has ED-315 been appropriately restructured, clarified and modernized in order to promote a more consistent and robust process for the identification and assessment of the risks of material misstatement. In particular:

- a) Do the proposed changes help with the understandability of the risk identification and assessment process? Are the flowcharts helpful in understanding the flow of the standard (i.e., how the requirements interact and how they are iterative in nature)?
- b) Will the revisions promote a more robust process for the identification and assessment of the risks of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6-28?
- c) Are the new introductory paragraphs helpful?

Response 1) The flowcharts are helpful in understanding the flow of the audit process. The first flowchart to identify and assess the risks of material misstatement is useful and diagrammatically presents at a high level the critical processes and objectives of the audit approach. In the second flowchart, the five components of the system of internal controls to understand the entity's risk profile, are aimed at evaluating entity controls to mitigate inherent risk and assess control risk. Accordingly, the first two flowcharts are connected, although this relationship is not drawn out in the diagram presented. Inherent risks are dependent on the nature of business operations and accordingly there can be no generic flowchart to depict such risks. However, based on generally accepted accounting practices, a basic flowchart for risks at the financial statement level could assist in understanding the risk of material misstatements from assertions at that level.

Question 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?
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Response 2) An auditor's understanding of the entity's control environment and its risk assessment process is affected by the entity's scale of operations. The complexity or simplicity of the operating model is a driver of risk assessment strategy. Control risk assessment outcomes are impacted by the effectiveness of an entity's implemented process controls to prevent inherent risks. On the other hand, inherent risks in business operations arise from the nature of business processes and could occur due to the susceptibility of these processes to inherent risks, irrespective of the scale of operations.

Accordingly, it is the size and complexity of the business process controls of an entity that would determine the scale, complexity and resources dedicated to risk management. The audit plan, together with an assessment of the effectiveness of risk controls, determines the level of reliance and testing procedures required at the individual business process levels.

The application material in the exposure draft is scalable to a wide range of sizes, complexities and circumstances. The Board may consider focusing the scalability factor in the audit approach to the effectiveness of the business control processes and risk management strategies adhered to within an entity.

Question 3

Do the 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?
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Response 3) Agree with the approach to include electronic data available in relation to automated tools and techniques for understanding the entity and its business model as noted in Appendix 1. The use of analysis, recalculations, reperformance and reconciliations will help to compile and summarize information, as well as draw conclusions on the illustrated examples provided.

These examples are useful in understanding business operations and processes for risk evaluation. However, understanding an operating entity for the purposes of developing a risk assessment involves obtaining a relative assurance about the degree of reliability that can be placed on management's assertions. These assertions include:

- Existence or occurrence;
- Rights and obligations;
- Completeness;
- Valuation; and
- Disclosures

Utilizing the examples illustrated will help practitioners make an assessment on these assertions. The Board may consider including wording to emphasize the focus on these assertions, as they assist in identifying the presence of potential inherent risks and the degree of effectiveness of entity controls. By including these assertions in the flowchart diagrams the audit methodology would be more comprehensive.

Question 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?

Response 4) Agree that the proposals support appropriately the application of professional skepticism throughout the audit process. Encouraging the exchange of information amongst the engagement team, interactions with internal auditors and the review of information from other regulatory and legal sources supports dialogue and assists in compiling the timing, nature and extent of substantive audit tests to be conducted.

The proposed change to obtain 'sufficient appropriate audit evidence' as a matter of the auditor's professional judgement to form the basis for the assessment of risks of material misstatement will encourage professional skepticism in the identification and assessment process. Professional skepticism not only improves audit performance, it also helps develop and create documentary evidence, as well as an audit trail to support the audit approach and opinion.

Question 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?
- 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?
- 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 identification and assessment of the risks of material misstatement?

Response 5) Agree.

Question 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?
- 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?
- c) In your view, will the introduction of the 'spectrum of inherent risk' (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks?
- d) Do you support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and their relevant assertions? Is there sufficient guidance to explain how they are determined (i.e., an assertion is relevant when there is a reasonable possibility of occurrence of a misstatement that is material with respect to that assertion), and how they assist the auditor in identifying where risks of material misstatement exist?
- 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?

Response 6)

- a) I agree with the proposal to separately assess inherent and control risk.
- b) The introduction of the concepts and definitions of 'inherent risk factors' brings clarity to a significant aspect of underlying risk in a business process. The assertions described as relevant are generally reflective of the fundamental qualitative characteristics of financial information applied by accounting frameworks.
- c-d) The standard calls for a tabulation of the susceptibility to risks at the assertion level in a class of transactions, account balances and disclosures on the spectrum of inherent risk. This would require a quantitative evaluation of risk on subjectively defined business processes. The revised standard suggests numerical categorizations (scale of one to ten) or relative classifications (high, medium, low) based on likelihood of magnitude and frequency. In addition, for greater consistency of approach in the application of the spectrum of inherent risk, business process risks at the assertion level should take into account past incidents, fraud occurrences within the industry and within specific business processes.

Complexity of business process should be defined by factors such as the number of persons involved in the business process, degree of automation and computer programming, the individual transaction value, the number of transactions etc. These attributes should be quantified, as a proportion of the size of the entity, in order to effectively reach a risk measure on the inherent risk spectrum. Measuring the gross effect on the class of transactions, account balances and disclosures through a broader range of common factors would then be a numerical exercise that is more objectively determinable. Additionally, multi-variable risk evaluation of business processes would help with the scalability issue as business processes would be assessed within the size and scope of the entity's operations.

Alternatively, risk of material misstatement could be assessed based on the materiality of financial statement disclosures. Material balances could be evaluated for their susceptibility to inherent business process risks and risks pertaining to effectiveness of existing controls. This would be a more efficient top-down format to evaluate risks based on their impact to material financial statement balances. In addition, relevant assertions are general in nature and impact all account classes, balances and disclosures. So narrowing down the scope to high value and significant financial statement KPIs that are material and can effectively influence the behavior of a market participant, would make the audit process more effective.

- e) I agree with the discussion material and definitions of significant risks in the exposure draft. Both the magnitude and likelihood of potential misstatement as a result of outliers in the normal course of business processes can lead to a significant risk to the overall financial position of an entity. However, the impact of magnitude and likelihood of risk occurrence can be better assessed by focusing on the risk of material misstatements in financial statements in order to achieve a fair representation of business results. An in-depth assessment of the susceptibility of all business processes to fraud would provide a complete evaluation of an entity's inherent risks

but the cost of time and resources deployed may outweigh the benefits. Materiality levels are relative to the scale of entity-wide operations and an assessment of significant inherent risks should also be relative to the operational scale. This would sharp focus audit resources to effectively and efficiently execute on significant risks assessed in an audit plan.

Question 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?

Response 7)

As noted in the additional guidance, the risk of material misstatement at the financial statement level resulting from the risk of management override of controls could pervasively impact business processes at the assertion level and as a result affect the overall integrity of financial information. Based on materiality levels for an entity and significant financial statement balances that could effectively alter decisions of stakeholders, the assessment of risk of material misstatement at the financial statement level, as noted in the standard, should extend to related process controls and their effectiveness to mitigate inherent risks.

Question 8

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

Response 8) Agree with the revisions made to paragraph 18 of ISA 330, which supports the evaluation of material classes of transactions, account balances and disclosures and requires substantive procedures for these classes. The requirement to have an auditor reconsider whether all significant classes of transactions, account balances and disclosures were identified once the initial risk identification and assessment processes are completed in paragraph 52 of ED-315 should feed into the revisions to paragraph 18 of ISA 330, to account for business scale, materiality and risk assessment of the effectiveness of controls on inherent risks. The decision should be based on expediency and risk exposures facing the entity.

Question 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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| <p>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?</p> <p>c) The other ISAs as presented in Appendix 2, are these appropriate and complete?</p> <p>d) ISA 540 (Revised) and related conforming amendments (as presented in the Supplement to this exposure draft), are these appropriate and complete?</p> |
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Response 9) The proposed conforming amendments as a consequence of the revisions in ISA 315, relating:

- to the separation of inherent risk and control risk compared to the combined risk of material misstatement in ISA 200 and 240;
- to the spectrum of inherent risk, inherent risk factors, relevant assertions and significant classes of transactions, account balances and disclosures introduced in the revised standard and explained in paragraph A40 in ISA 200 and in paragraph A43a in ISA 330 to merge the meaning of the purpose of identification and assessment of risks of material misstatement at the assertion level;
- to clarify the work effort related to understanding an entity's system of internal controls new paragraphs in ISA 240;
- to new amendments in ISA 330 to reflect the concepts of significant classes of transactions, account balances and disclosures in the revised ISA 315;
- to recognize that materiality relates to both quantitative and qualitative aspects in ISA 330; and other such changes are appropriately noted by the Board.

For an appropriate interpretation and application of these concepts, these revisions must be read in conjunction with other ISA, and their implementation must be consistent with substance over form in order to ensure completeness in implementation of these conforming amendments.

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?

Response 10) Agree, see response 8, above.

Question 11

In addition, the IAASB is also seeking comment on the matters set out below:
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- 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 not in reviewing the ED-315.
- b) Effective Date: Recognizing that ED-315 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.

Response 11 b) Agree with the IAASB's timeline for implementation of the ISA. The exposure draft clarifies and improves upon the existing standard, so an implementation period of eighteen months seems reasonable for effective adoption of the revised standard.

If you have any questions, please do not hesitate to contact me by email at lynessadiaz@gmail.com.

Yours sincerely,

Lynessa Dias, CPA, CGA, CFA, FRM, CAIA