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Date Re Our ref Attachment
30 oktober 2018 ED ISA 315 KvH

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Dear Mr. Schilder,

Introduction and main issues

The NBA appreciates the opportunity to share our views and provide input on the Exposure Draft *International Standard on Auditing 315 Identifying and Assessing the Risks of Material Misstatement (Revised)* (hereafter the 'ED'). We will start our input with an introduction and main issues and we will provide our responses to IAASB's specific questions afterwards.

We understand the need to revise ISA 315 in the public interest. A thorough understanding of the auditees processes and environment and a robust risk identification and assessment process is the cornerstone for a quality audit. Based on our own experience and on outcomes of inspections it is clear that the risk assessment process needs to be strengthened and better explained.

In our opinion the exposed draft of ISA 315 is not as clear as it could and should be. We have identified several fundamental areas for improvement that we will describe below. We have tried not only to identify the areas for improvement but also to provide suggestions how the standard can be improved. We are willing to work with the task force to further explain our thoughts and to implement our suggestions.

Our main issues are :

1. Risk based audit approach including controls testing:
 - a. In the ED, the auditor starts with identifying risks of material misstatement. Based on the theory of the audit risk model, this does not seem correct. The risk is that the auditor with this combined identification assumes that controls are effective without testing them and thus does not gather sufficient and appropriate audit evidence for related (inherent) risks. Therefore we suggest to change the flow of the process in the standard so that after gathering the understanding the auditor first identifies relevant inherent risks of material misstatement.
 - b. Controls are present in all components of internal controls and have to be tested if the auditor will rely on the system of internal control. Although indirect controls are difficult to test, they can mitigate the risks of material misstatement. We urge the IAASB to further investigate how these indirect controls can contribute to the audit without fully testing them. At the same time we urge the IAASB to change the assumption that the system of internal control is expected to operate effectively before the actual testing thereof is performed. The IAASB should make clear that only after appropriate testing the control risk can be assessed at less than maximum. A more fundamental revision of ISA 330 should be done to do so.

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The logo for the Royal Netherlands Institute of Chartered Accountants (NBA) features a solid orange horizontal bar above the letters 'NBA' in a bold, orange, sans-serif font.

- c. In our opinion there are more levels than material misstatements at the financial statement level or assertion level. We suggest to make clear that these kind of risks are covered by the risks at the financial statement level.
 - d. We feel that the concept of aggregation of risks is not well explained. We advise the IAASB to explain in the standard how this should be applied.
 - e. The ISA explains that in certain situations substantive procedures alone are not enough and the auditor should test the effectiveness of internal controls. We feel that it is necessary to better explain this concept in the standard.
 - f. The standard explains that in small and medium sized entities internal control is more informal. The standard does not provide guidance whether and how these more informal controls can be tested. We recommend the IAASB to provide guidance on the possibilities to test controls within SMEs.
2. The impact of IT and automated tools and techniques:
 - a. We acknowledge the attention given to IT. However, in the ED, IT is dealt with as a separate subject matter and described in a complex and detailed way. IT based controls are the norm and not the exception. We suggest to integrate IT controls and simplify the text.
 - b. Automated tools and techniques are mentioned in the ED but only in the application material with some examples. We recommend that the IAASB gives this more prominence and pay more attention as to how these tools and techniques can be applied in practice to provide sufficient and appropriate audit evidence.

3. Complexity and understandability:

We consider the ED to be very elaborate, complex and difficult to understand. It is hard to comprehend and fully understand the whole process and not getting lost in the details. A lot of new concepts are introduced and the relationships between them are not always clear. We recommend to improve the understandability and readability of the ISA by further aligning the concepts and the clarification thereof. Furthermore we recommend to keep it simple. Simplifying the standard could be done by rethinking whether all paragraphs are necessary (especially the application material) and how the material can be presented best (e.g. by providing illustrative figures).



Request for Comments

Overall Questions

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

 - a) *Do the proposed changes help with the understandability of the risk identification and assessment process? Are the flowcharts helpful in understanding the flow of the standard (i.e., how the requirements interact and how they are iterative in nature)?**

We are reluctant whether the risk identification and assessment process has become more understandable. A lot of new concepts are introduced which are not always elaborated and the relationships between them are not always clear. We wonder what the status of the key concepts is which are de-scribed in the introduction and not in the requirements.

If we had to explain a risk based audit of financial statements in an elevator pitch we would explain that in an audit:

- The auditor gathers information to understand the entity and the environment in which it operates and the applicable financial reporting framework and based on that knowledge identify risks that could materially misstate the financial statements;
- The auditor tries to understand and evaluate what the client has done to identify those risks and to mitigate them by getting an understanding of the internal control framework and testing the effectiveness thereof where relevant; and
- The auditor performs substantive procedures to mitigate the risk of material misstatement to an acceptable level of audit risk.

These three bullets are reflected in the audit risk model. The first bullet leads to the inherent risk, the second bullet reflects the control risk and the third bullet reflects the detection risk. Combining inherent risk and control risk leads to the risk of material misstatement.

According to the flowchart: 'ISA 315 (Revised) Identifying and Assessing the Risks of Material Misstatement' after getting an understanding of the entity and its environment, the applicable financial reporting and the entity's system of internal control the auditor starts with identifying risks of material misstatement. We would say that according to the theory of the audit risk model this is not possible. The risk is that the auditor with this combined identification assumes that controls are effective without testing them and thus does not gather sufficient and appropriate audit evidence for related (inherent) risks.

We therefore suggest to change the flow of the process in the standard so that after gathering the understanding the auditor first identifies relevant inherent risks of material misstatement. These inherent risks may influence the financial statements as a whole or might influence relevant assertions at classes of transactions, account balances or disclosures.

Given the fact that with regard to identified risk at the financial statement level testing of effectiveness controls is not included in the process, inherent risks at that level equal the risk of material misstatement.

The iterative nature is not so clear because the ED and the flowcharts are quite complex. Furthermore, the ISA is very elaborate and shows a lot of repetition and duplication (e.g. paragraphs 19-21 relate to the same subject matter, namely using audit evidence obtained in previous or other engagements). There are also a lot of references to other ISAs and paragraphs that are mentioned in other ISAs. This makes it difficult to navigate through the ED and fully comprehend the ED.

- 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?*

The ED is unnecessarily complex. We recommend to make the concepts and the relationships between them clear, describe the concepts in the requirements and clearly visualize them by providing some illustrative figures. We also recommend to avoid duplication and repetition, delete references to other ISAs where possible and reconsider how the ED could be simplified.

The public interest issues are dealt with in following questions. In general, we have the impression that the issues are discussed, but not really solved by adding some paragraphs. The issues require more than that.

- c) Are the new introductory paragraphs helpful?*

See Question 1a.

- 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 concept of scalability is described in the ISA, but in our opinion it will be difficult to apply this concept effectively and efficiently in practice. The ED contains the implications for smaller and less complex entities, but not by the principle of "think simple first". The auditors of smaller and less complex entities need to read the whole ISA first and then sort out what is not applicable for them. We recommend to explore whether it is possible to turn this around.

- 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 acknowledge that automated tools and techniques are mentioned, but only in the application material. We understand IAASB's reluctance to prescribe too much in detail (and rules based), but we consider only examples not to be sufficient to enable the use of automated tools and techniques. In our opinion, more attention should be paid as to how these tools and techniques, including data analytics can be applied in practice. For example how data analytics provides sufficient and appropriate audit evidence.

- 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?*

Although the term professional scepticism is mentioned a few times, we do not consider this appropriate. It is not clear what needs to be done, only that contradictory information needs to be taken into account.

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?*

It is not clear why the auditor should understand each component of the entity's system of internal control if the auditor will not rely on the system of internal control and will set the control risk at the maximum. We recommend to make clear that the system of internal control remains important to consider, even when a substantive audit approach is adopted. There are risks for which substantive procedures alone are not sufficient. An understanding of the system of internal control will help to understand the entity, perform an appropriate risk identification and assessment process and design an appropriate audit approach.

In our opinion more attention should be given to culture and behavior (also sometimes referred to as 'soft controls'). Although culture and behavior are mentioned (e.g. tone at the top is mentioned in the explanatory memorandum, but not in the ED itself), we feel that this could be elaborated more in the ED. In the new COSO ERM model more attention is paid to governance and culture as well. In recent business and audit failures, the deficiencies in 'soft controls' played an important part.

In line with COSO the system of internal control exists of 5 components who together can ensure that an entity is in control. Within all these components an entity can design and implement controls. According to the flowchart 'Obtaining an understanding of the Entity's System of Internal Control – ISA 315 (Revised) Para 25-44 the evaluation of the first three components (Control environment, risk assessment and monitoring controls) can lead to the identification of risks of material misstatement at the financial statement level. The controls within the last two (information system & communication and control activities) can lead to lower levels of control risk for relevant controls when effectiveness of the controls is proven.

The flowchart suggests that the evaluation of the first three components can only lead to the identification of risk and that it does not lower (control) risk / risk of material misstatement. Although we acknowledge that testing of the effectiveness of indirect controls is challenging it seems not realistic to deny that tone at the top, culture etc. influence the risk of material misstatement. At the same time assuming effectiveness without testing is inconsistent with the standards statement that control risk is maximal when effectiveness is not proven through testing.



We wonder whether the standard sufficiently recognizes the way in which entities organize their system of internal control and thus manage being in control. We are convinced that the control environment influences the likelihood of risks occurring and thus we feel that indirect controls in this area, although difficult to test, diminish the risk of material misstatement. We urge the IAASB to further investigate how these indirect controls can contribute without fully testing them. Although this seems new territory we take a similar approach during the risk assessment. Based on risk assessment procedures we determine inherent risks and relevant assertions. In reality we decide which assertions are not relevant. If we did not perform risk assessment procedures all assertions would be relevant.

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

The definition of controls seems to be narrowed. In the current ISA the process is mentioned to achieve the entity's objectives. In the ED it concerns the policies and procedures to achieve the control objectives. In our opinion, the new definition is too narrow although policies and procedures are meant as a broad term. Controls are more than just policies and procedures. We recommend to reconsider this.

The fallacy of the assumption that the system of internal control is expected to operate effectively before the actual testing thereof still exists in paragraph 50. This is a self-fulfilling prophecy. Before the auditor can assess the control risk at less than maximum, he should first test the operating effectiveness of the controls and not the other way around. If the auditor assumes that the controls are operating effectively, he will not perform many audit procedures to test this and as a result he will not find control deficiencies. Then he relies inappropriately on the operating effectiveness of the controls. The phrase 'control risk at lower than maximum' might suggest that limited testing of controls might be appropriate whilst extensive testing of controls is required in this case. This is also not clear in the conforming amendments in ISA 330. Risk assessment and risk response are mixed up. We recommend to change this and make clear that only after appropriate testing the control risk can be assessed at less than maximum. This should be mentioned briefly in ISA 315 and elaborated in detail in ISA 330, which should be revised more than just the current conforming amendments.

In the ED mainly the design and implementation of controls is mentioned (e.g. paragraph 39e). More attention should be given to (the testing of) the operating effectiveness of the controls.

It is not clear what should be done in the case when substantive procedures alone are not sufficient and controls are not operating effectively. We recommend to provide guidance in this area.

The standard explains that in small and medium sized entities internal control is more informal. The standard does not provide guidance whether and how these more informal controls can be tested. We recommend the IAASB to provide guidance on the possibilities to test controls within SMEs.

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?

There is sufficient attention to IT. However, in the ED IT is dealt with as a separate subject matter. It would be better to integrate this within the audit and not treat it separately.

Furthermore, we wonder whether it is clear when GITC should be considered, what the impact is on other audit procedures and what the relationship is with application controls. The subject matter is described in a complex and detailed way especially for audits of smaller and/or less complex entities. We recommend providing clear guidance which audit procedures should be performed when only standard commercial software is used in the entity.

Finally, in the ED mainly the design and implementation of IT controls is mentioned (e.g. paragraph 42). More attention should be paid to (the testing of) the operating effectiveness of the IT controls.



6) *Will the proposed enhanced framework for the identification and assessment of the risks of material misstatement result in a more robust risk assessment? Specifically:*

a) *Do you support separate assessments of inherent and control risk at the assertion level, and are the revised requirements and guidance appropriate to support the separate assessments’?*

We support separate assessments. See also Question 1a.

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?*

We are not sure whether the new concept of ‘inherent risk factors’ will be fully understood in practice. We understand that they will have an impact on the risk assessment, but it is not clear how they should be taken into account. We recommend to provide guidance how they affect the process e.g. how these factors should be weighted if there are more factors applicable.

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 introduction of the ‘spectrum of inherent risk’ as such is fine, as it gives more refinement. However, the concept is not explained in detail. We feel that an illustration could help (e.g. the illustration as presented in the IAASB Board Meeting in June 2018 with the magnitude and likelihood presented in a diagram).

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?*

This concept was already mentioned in the current ISA, but apparently now it is more detailed out. We wonder what the actual change is. Furthermore, the difference between significant classes and material classes is not very clear. Perhaps a figure or an example might help.

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?*

According to us, the definition has been improved. However, the second part of the definition is still circular (‘treated as a significant risk in accordance with the requirements of other ISAs’). Furthermore, we wonder whether the ‘or’ in the first bullet (‘or the magnitude...’) is correct. In our opinion this should be an ‘and’. When both the likelihood and the magnitude are at the upper end, there is a significant risk. We recommend to change this.

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?*

Misstatements will always occur in account balances, classes of transactions or in disclosures. This goes for risks of material misstatement at the financial statement level and for risks of material misstatements at the assertion level. In our opinion there are more levels that can lead to material misstatements. For instance risk of material misstatement can result from doing business in a certain



geographical area, divisions, subsidiaries or processes within the business process of a group or product groups.

Although we do not suggest to alter the ISAs to reflect this we suggest to make it clear that these kind of risks are covered by the risks at the financial statement level. We feel that this would help users to better understand the risk of material misstatement at the financial statement level

Risk at the assertion level are relevant when these risks alone or aggregated can lead to material misstatement. We feel that this concept is not well explained. In principle all misstatements can together with other misstatements lead to material misstatements. We advise the IAASB to explain in the standard how this should be applied.

In the requirements little attention is paid the risks at the financial statement level and these risks are also dealt with rather late in the ED. We recommend to pay more attention to these risks in the requirements and at an earlier stage in the process.

Management override and relating concerns about management's integrity are mentioned as concrete example in the application material. Another example that could be mentioned is a material uncertainty relating to going concern. It could be stated more clearly that it is difficult to determine how this affects the assessment of risks at the assertion level and that this depends on the specific circumstances.

- 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?*

In our view, the proposed stand-back requirement in ISA 315 is appropriate. This moment of reflection enhances the risk assessment process. By already stating this in ISA 315, this reflection is made earlier than when previously it was only mentioned in ISA 330. The requirement in ISA 330 can be maintained as this requirement is useful as well. More moments of reflection in the audit will have a positive effect on the audit.

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)?*

It is rather confusing that part of the conforming amendments are presented in the ED and another part is presented in the Supplement to the ED which was issued later.

- 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?*

In our opinion it is better to revise ISA 315 and ISA 330 simultaneously. Only 'conforming amendments' in ISA 330 are not sufficient. We have the impression that the consequences of all changes in ISA 315 are not properly reflected in ISA 330. Furthermore, there is interaction between ISA 315 and ISA 330 which is not taken into account completely. For example the consequences of the 'spectrum of inherent risk' are not elaborated in ISA 330 and the consequences of controls not operating effectively on the assessment of control risk are not mentioned. We also do not see the concept of general IT controls relevant to the audit elaborated in ISA 330 (see also Question 5b).

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

It is difficult to review the conforming amendments in the other ISAs as these are only summarized in the ED, but not presented. We would like them to be presented in order to review them properly.

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

It is very confusing as these conforming amendment are presented in a Supplement to the ED which was issued later. Furthermore, not only the conforming amendments are presented, but the whole revised ISA 540. We prefer to see the conforming amendments only, as this is easier to review instead of navigating through the whole revised ISA 540.

- 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?*

See also question 8. According to us, paragraph 18 of ISA 330 has not been changed fundamentally.

Request for General Comments

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

- a) *Translations—recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-315.*

The ED is very difficult to understand and needs significant improvements to provide more clarity in the concepts used and to eliminate repetition. Difficulties to understand the language used will lead to inconsistencies in translation. Specific examples of terminology that will be difficult to translate are 'more than remote' and 'closer to the upper end', since these constructions are particularly difficult to represent.

- b) *Effective Date—Recognizing that ED-315 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.*

We consider a period of 18 months for implementation after approval of the final ISA a reasonable period. We support earlier implementation as ISA 540 will be applicable earlier and the ISAs are inter-related.



Closing Remarks

For further information, please contact Jan Thijs Drupsteen (J.Th.Drupsteen@nba.nl.)

Yours sincerely,

NBA, the Netherlands Institute of Chartered Accountants,

Signed by
Anton Dieleman
Chair of the Dutch Assurance and Ethics
Standards Board