

October 26, 2018

IAASB  
529 Fifth Av  
New York  
NY 10017

Dear Sir/Madam

This letter contains some comments on the ISA 315 exposure draft.

As an introduction, the FocusROI group of companies serve small and medium sized accounting firms. Our goal is to enable partners and staff understand and comply with professional standards in an efficient manner. We also perform quality assurance reviews, prepare continual improvement plans and conduct training programs. Our services are similar in many ways to those provided by the larger national firms through their 'national' offices.

Our responses have followed your questions. We hope that we have provided sufficient information to explain our suggestions. If not, we would be pleased to provide additional information

### **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)?

Overall, we believe this revised standard is a great step forward. The flowcharts are very useful except for our one major comment relating to understanding internal control which is outlined below.

Para 25 of the ED states:

*"The auditor shall perform risk assessment procedures to obtain an understanding of the entity's system of internal control relevant to financial reporting, by understanding each of the components of internal control"*

The standard as a whole and the overall flow chart seems to imply that internal control is an end in itself, rather than managements response to mitigate specific

risks. Risk comes before control. If a control exists without a risk to mitigate, it is totally reductant.

We believe that the increased emphasis on understanding and evaluating internal control, is useful guidance, but overkill for a small audit that is unlikely to ever assess control risk at less than the maximum. However, the guidance provided would be very useful if the auditor was required to opine separately on internal control. But that is not the case in this standard.

The overview flow chart provided with the exposure draft seems to imply that understanding internal control is a separate activity that could run in parallel to the risks being identified through understanding the entity. We believe it would be more helpful to indicate that the assessment of both risk and control are closely intertwined and should be performed one after the other. This is explained below.

The so called “top down and risk-based approach” that came out of the US requirements to report separately on internal control made a lot of sense and saved enormous amounts of time in practice. However, it appears to us that some of that learning may not have been incorporated in this revised standard.

The “top down risk-based approach” replaced the inefficient, time consuming and costly ‘bottom up’ approach.

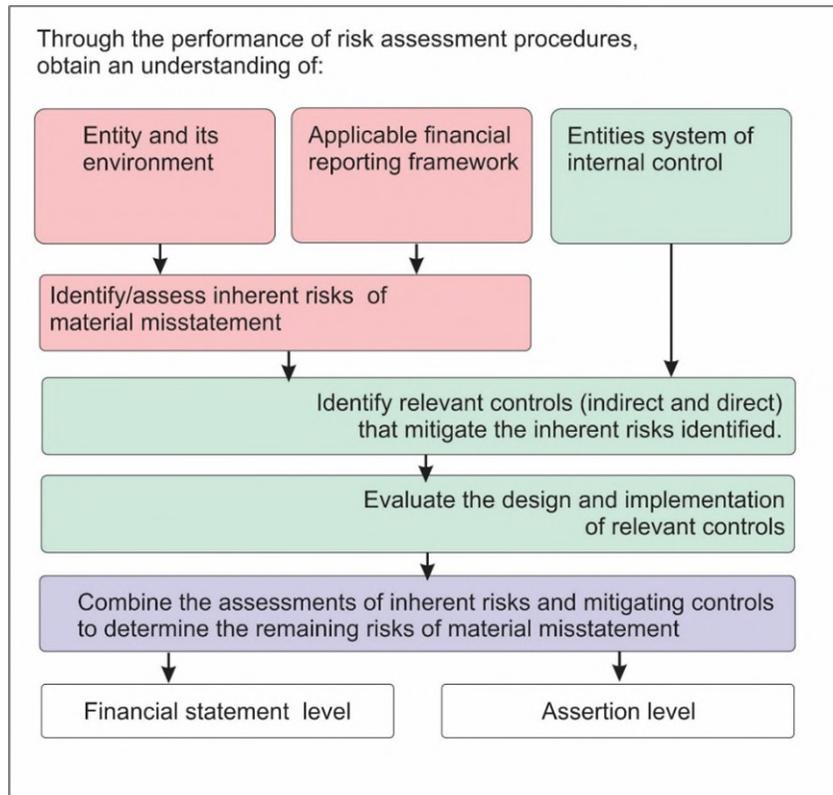
In the “bottom up” approach auditors started their work by producing elaborate (and often unreadable) flow charts to document all existing controls (relevant or not). A walk through was then performed to ensure all the identified controls (relevant or not) actually existed and were in operation. The final step was to then to match the identified controls (relevant or not) on the flow charts to possible inherent risks.

The “top down” approach starts by first identifying and assessing the inherent risks of misstatement and then (secondly) inquiring what management controls exist to mitigate these risks. Controls that are not relevent would never be documented or assessed at all.

ED 315 seems to incorporate elements of both the top down and bottom up approaches to assessing risk and control. If this is intentional, we believe we are missing a great opportunity as a profession to make auditing more effective and efficient in general.

We recommend that the standard specifically state that risk comes before control. We believe this would go a long way in answering virtually all of the questions/concerns posed by practitioners, which are outlined in paragraph 30 of the exposure draft.

If the inherent risk assessment was performed *before* identifying the relevant controls the overview flow chart would be revised as follows.



Some of the practical benefits of a “top down” approach are:

- Only relevant controls (i.e., those that specifically treat the risks identified) need be documented.
- Documentation that matches risks and controls is a lot easier to update each year than flow charts and system narratives.
- Significant weaknesses in internal controls can be readily identified.
- Only well-designed and relevant internal controls need be evaluated for control implementation. Cradle-to-grave walkthroughs are no longer required.

(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 revisions are helpful but do not go far enough. At a time when the focus of regulators is to improve the quality of auditing, we believe that the revised ISA 315 would have been a great opportunity to include additional practical guidance on how to perform effective risk assessment procedures.

For example, there is no additional guidance provided to practitioners on how to identify and assess risks that could affect the future viability of the entity. The guidance is ISA 570 and ISA 240 is simply not enough.

In our experience, practitioners can readily identify and access the **effects** of risks that impact specific financial statement areas, but often fail to consider the **sources** of such risks and possible other implications. Risk sources can often affect many FS areas from both a historical and future perspective. For example, most auditors will identify the effect of a risk that could lead to the need for a provision for doubtful

accounts. But they may fail to consider whether the **source** of the risk (such as a downturn in the economy) also effects other financial statement areas or even the future viability of the entity itself. Auditors should be encouraged to first identify the sources of risk and its future implications as well as the effects on the current year end balances and the income statement.

(c) Are the new introductory paragraphs helpful?

Yes, they provide a good overview of the changes

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?

Yes, with the exception of our comments on the approach to understanding internal control in point 1a above

3) Do respondents agree with the approach taken to enhancing ED-315 in relation to automated tools and techniques, including data analytics, through the use of examples to illustrate how these are used in an audit (see Appendix 1 for references to the relevant paragraphs in ED-315)? Are there other areas within ED-315 where further guidance is needed in relation to automated tools and techniques, and what is the nature of the necessary guidance?

We agree with the new material and 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.

This is a good start but we believe much more guidance is needed on the practical use of professional skepticism.

Our experience is that staff are still willing to accept whatever the client says, particularly when they have a tight budget. It would be worth exploring the applicability of some of the techniques now being used by forensic auditors such as in evaluating information obtained or in learning how to watch for obvious body language clues when making inquiries.

### **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.

Do not disagree with the guidance provided but it will not be liked (or even understood) by auditors of smaller entities who often fail to appreciate the specific audit implications and linkages between an adequate control environment component and the nature and extent of substantive procedures to be performed.

We also do not understand why assessing design and implementation does not apply to indirect controls such as those found in the control environment and risk assessment. Absence of such controls is often a critical contributor to risk.

- 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?

Please refer to our detailed response to this question outlined in question 1a above

- c) Do you support the introduction of the new IT-related concepts and definitions? Are the enhanced requirements and application material related to the auditor's understanding of the IT environment, the identification of the risks arising from IT and the identification of general IT controls sufficient to support the auditor's consideration of the effects of the entity's use of IT on the identification and assessment of the risks of material misstatement?

Yes, but this will be a struggle for a lot of smaller practitioners to understand. New training programs are needed here.

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

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

We support the separate assessments of inherent and control risk but do not see them as being performed independently of each other. Identify and assess the inherent risks first and then inquire how management mitigates the risk. Refer to our response to question 1a above.

- 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 support the concepts and definitions of 'inherent risk factors'

- d) 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?

Yes, especially when a numeric scale such as 1-5 is used to assess likelihood of occurrence and magnitude rather than the simple high medium and low. Some discussion of how to use numeric evaluations would be helpful in the application material

e) 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?

Yes

f) 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?

Yes, we are in full support but fail to understand why high magnitude is deemed significant by itself and therefore more important than likelihood of occurrence.

7) Do you support the additional guidance in relation to the auditor's assessment of risks of material misstatement at the financial statement level including the determination about how, and the degree to which, such risks may affect the assessment of risks at the assertion level?

We support the additional guidance.

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

We support the stand back and believe it should be retained in both places.

As stated earlier we support much of the proposed standard and appreciate all the work that went into its preparation.

We would also be pleased to answer any questions you might have.

Yours truly

Stuart Hartley FCPA

FocusROI Inc.