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International Auditing and Assurance Standards Board
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Via IAASB website at www.iaasb.org

Dear Board Members and Staff:

Grant Thornton International Ltd appreciates the opportunity to provide input on the International Auditing and Assurance Standard Board's (IAASB) Exposure Draft – Proposed International Standard on Auditing 315 (Revised) – Identifying and Assessing the Risks of Material Misstatement and Proposed Consequential and Conforming Amendments to Other ISAs (ED 315).

We welcome the efforts to revise ISA 315 (Revised) to improve its clarity and the robustness and consistency of its application, and we appreciate the efforts of the IAASB to provide education on the proposals in ED 315 prior to the close of the comment period.

Overall, we are concerned that the scope of the proposed amendments to ISA 315 (Revised) are far in excess of those originally contemplated by the project scope, which included, amongst others, the objectives of:

a) Establishing more robust requirements and appropriately detailed guidance to drive auditors to perform appropriate risk assessment procedures in a manner commensurate with the size and nature of the entity; and

b) Determining whether and how ISA 315 (Revised), in its organization and structure can be modified to promote a more effective risk assessment.

We are supportive of some of the proposals in ED 315 including:

- The requirement to perform a separate assessment of inherent risk and control risk when assessing the risks of material misstatement at the assertion level.

- The new definitions of significant classes of transactions, account balances and disclosures and of relevant assertions; subject to further clarification of how these definitions would be applied in practice.

- The concept of providing guidance to assist the auditor in assessing inherent risk; subject to our specific comments on the descriptions of the inherent risk factors and further clarification of their role in assessing inherent risk.

- The introduction of the new IT concepts; subject to further clarification and refinement of the extent of the required understanding and evaluation of the IT environment and the interaction of the IT concepts with the related business processes.

As elaborated further in our detailed response, there are, however, several areas where we have concerns over the proposals in ED 315:

- The information system and communication component. As currently drafted, we are of the view that this component is a fatal flaw in the ED 315 proposals, as it has achieved neither the clarity nor the scalability objectives. This component includes a requirement to obtain an understanding of the information system relevant to financial reporting. This requirement conflicts with, and potentially negates, the requirement in the control activities component, to evaluate the design and determine the implementation only for those controls that are relevant to the audit. It will result in the auditor understanding and evaluating controls that are not relevant to the audit and that are far more than those necessary to plan and perform an effective and efficient audit.

- The lack of consideration of how the evaluation of the design of controls and determination of their implementation, absent testing the effectiveness of the controls, impacts the auditor's assessment of the risk of material misstatement, as control risk will be assessed at maximum and inherent risk is assessed without regard to controls. This will have a consequential impact on the procedures that are performed by the auditor, particularly when using audit sampling in response to the assessed risk of material misstatement.

- The introduction of the concept of obtaining sufficient appropriate audit evidence in the context of the auditor's risk assessment and the implications of how this will interact with the ISA 500[1] requirement to obtain sufficient appropriate audit evidence to support the auditor's opinion and report.

- The proposed definition of significant risk in terms of the likelihood or magnitude of a potential misstatement will drive inconsistencies in its practical application, especially in

1 ISA 500, *Audit Evidence*

multi-jurisdictional audits where the definition of significant risk may differ. For example, a risk identified as being significant based on its likelihood or magnitude may not require special audit attention and therefore would not meet the definition of a significant risk under certain other jurisdictional auditing standards.

- The proposed definition of significant risk does not address the identification of a significant risk at the financial statement level.

- The lack of a logical sequence to some of the proposed requirements and the complexity of the proposed standard such that flowcharts are required to facilitate the auditor's understanding of the proposals; the flowcharts themselves are also multifaceted and complicated.

- A perceived reduction of scalability of the standard in a number of areas.

We are of the view that the proposed amendments are unlikely to lead to significant positive change in behaviors, and when considered in conjunction with the flowcharts, would lead auditors down a path that is reminiscent of adhering to an audit methodology, rather than a principles-based standard that can be universally adopted. Consequently, we believe that audit quality may be negatively impacted.

We respectfully submit our detailed responses to the ED 315, which elaborates on the points highlighted above. We would be pleased to discuss our comments with you. If you have any questions, please contact Sara Ashton at sara.hm.ashton@uk.gt.com or at +1 646 825 8468.

Sincerely,

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Enc: Responses to Exposure Draft – Proposed International Standard on Auditing 315 (Revised) – Identifying and Assessing the Risks of Material Misstatement and Proposed Consequential and Conforming Amendments to Other ISAs

Responses to IAASB's Exposure Draft – Proposed International Standard on Auditing 315 (Revised) – Identifying and Assessing the Risks of Material Misstatement and Proposed Consequential and Conforming Amendments to Other ISAs

Detailed below is our detailed response to the IAASB's request for comments to Exposure Draft – Proposed International Standard on Auditing 315 (Revised) – Identifying and Assessing the Risks of Material Misstatement and Proposed Consequential and Conforming Amendments to Other ISAs.

Questions

Overall Questions

Q1. 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)?

Although a step forward, we do not believe that the proposed changes to extant ISA 315 (Revised) have achieved the overall goal of its clarification. We are of the view that the changes proposed appear more reflective of an audit methodology rather than a principles-based standard.

The proposed standard consists of 54 requirements with 274 paragraphs of application material and 4 appendices to explain those requirements. Furthermore, 3 flowcharts have been developed to guide the auditor through the standard. This, in and of itself, creates challenges for auditors in understanding the proposed requirements, obscures the keys aspects of those requirements and, as a consequence, may result in issues with their implementation and with meeting the overall objective of improving audit quality.

Further, even recognizing that risk assessment is an iterative process, the order in which some of the requirements are presented does not appear to be a logical sequence. For example, paragraph 45 requires the auditor to assess the risks of material misstatement at the financial statement level and at the assertion level for classes of transactions, account balances and disclosures. This is followed by paragraph 46, which then requires the auditor to determine the significance of the class of transactions, account balance and disclosures and their related assertions based on that assessment. As such, the proposals would appear to be requiring the auditor to first assess inherent risk and then decide to which significant class of transactions, account balance or disclosure the inherent risk assessment relates. This process may be better understood if the proposals included a requirement to make a determination of the significant classes of transactions, account balances and disclosures, in conjunction with identifying and assessing inherent risks. Further, the proposals could clarify that as the engagement team continues with its risk assessment procedures, this determination may be modified.

We are of the view that the flowcharts are integral to understanding the proposals in ED 315. However, similar to the standard, the flowcharts are overly complex and would benefit from simplification. We are also concerned by the need to rely on such guidance to facilitate comprehension of the standard instead of being a useful supplement to the proposed standard.

b) Will the revisions promote a more robust process for the identification and assessment of the risks of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6-28

We are of the view that the revisions will go some way to addressing the public interest issues outlined in paragraphs 6-28 of the Explanatory Memorandum, but we do not believe that they will fully address all of those issues. In particular, we would highlight our concerns about the scalability of these proposals as an area where the public interest has not been fully addressed.

We do not believe that the proposed revisions to ISA 315 (Revised) will promote a more consistent and robust process for the identification and assessment of the risks of material misstatement. Specifically:

- The length and complexity of the proposals will increase the risk that the requirements and associated guidance will be inconsistently interpreted and applied in practice.
- The need for flowcharts and 12 paragraphs of introduction to the proposed standard both add to the complexity of the standard and further emphasizes its complexity because such explanatory material was considered necessary to understand the proposal.
- The need to rely on guidance, such as extensive application material, appendices to the proposed standard and flowcharts, to understand

the iterative nature of the risk assessment process impairs the clarity of the proposed standard.

- Certain sections of the requirements have made the proposed standard less scalable than extant, for example:
    - the required extent of the understanding and evaluation of the information system and related controls.
    - the lack of perceived benefit to the auditor from assessing the design and implementation of controls. For example, it is not clear how understanding the design and implementation of controls affects the procedures performed by the auditor, as control risk will still be assessed at maximum (unless tests of operating effectiveness are performed) and inherent risk is assessed without regard to controls.
    - the definition of significant risk suggests that a risk that has a high magnitude of potential misstatement but a low likelihood of occurrence (and vice versa) could now become a significant risk and, as such, could inappropriately extend the population of significant risks on engagements.
    - the inference that there will be a significant risk (other than those required by ISA 240[2]) on practically every engagement.
    - the lack of explicit signposting throughout the standard for considerations relating to smaller entities.

c) Are the new introductory paragraphs helpful?

We are of the view that some of the information in the introductory paragraphs is helpful in understanding ED 315 and, in particular, the iterative nature of performing risk assessment procedures. However, these paragraphs should not alleviate the need for the auditor to read and understand the ISAs or the proposed standard in its entirety, nor result in the impression that without such paragraphs, the auditor would not have the knowledge to understand the ISAs or the proposed standard. We believe that, to reduce the overall complexity of the proposed standard, many of the concepts within these paragraphs can be included in the relevant section of the application material, to the extent that the concept is either unclear or not otherwise incorporated into that section.

Q2. 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 range of sizes, complexities and circumstances?

[2] ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

Overall, we are supportive of the amendments made to the control activities component, and in particular, that paragraph 38 of ED 315 only requires evaluation of the design and determination of the implementation of the controls relevant to the audit.

However, we are concerned that the following proposed changes to extant ISA 315 (Revised) will be contrary to the promotion of the scalability of the standard:

- The extent of the understanding of controls, in particular, remains unclear why an auditor would be required to understand the design and implementation of controls, if control risk always has to be assessed at maximum, unless the auditor intends to test the operating effectiveness of that control. In particular, we are concerned about the potential impact this will have on audit sampling, which currently allows some 'credit,' albeit small, for obtaining an understanding of controls and the control environment.
- The requirement in paragraph 35 of ED 315 requires the auditor to "understand the information system relevant to financial reporting, including related business processes, through understanding how information relating to significant classes of transactions, account balances and disclosures flows through the entity's information system." This would appear to contradict paragraph 39, which states that "not all controls that are relevant to financial reporting are relevant to the audit," by bringing into scope the business processes and controls related to significant classes of transactions, account balances and disclosures.
- The removal of the sign posting of considerations specific to smaller entities makes it more difficult for auditors to identify these specific considerations and may have the consequence of negating the efforts to make the standard more scalable for smaller firms. We also note that the Explanatory Memorandum is silent on whether the IAASB will be revising the other ISAs to eliminate the inconsistency created by this change in format. Such inconsistency would seem contrary to the premise of the clarified standards.

The Explanatory Memorandum also indicates the view that these are considerations for smaller ***and*** less complex entities and then goes on to note that some of these considerations may be applied to larger less complex entities. As such, it would appear that the focus is on the complexity of the entity rather than its size, and we question whether it would be more appropriate to use the term "smaller ***or*** less complex entities."

Q3. 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 there 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 approach taken to enhance ED 315 in relation to automated tools and techniques, including data analytics, and through the use of examples to illustrate how they are used in an audit. However, we would recommend that the IAASB consider the potential for working on a definition of "automated tools and techniques" in the future, as artificial intelligence becomes more prominent in the profession.

Q4. 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?

We note that the Explanatory Memorandum indicates that professional skepticism has been encouraged in the following ways:

- The introductory paragraphs to ED 315 emphasize the importance of exercising professional skepticism.
- Six application material paragraphs include references to professional skepticism and its role in risk assessment.
- Guidance has been provided around contradictory information.

We are supportive of the inclusion of references in the application material for the auditor's consideration of contradictory information. We are of the view that these paragraphs will serve as a useful reminder to auditors in their performance of an audit engagement.

However, we are also of the view that the enhancements in general support better application of professional judgment in the performance of an audit engagement, rather than the appropriate application of professional skepticism. The promotion of the appropriate application of professional skepticism would be better facilitated by ED 315 making a better connection to ISA 240 and in particular, the requirements relating to risk assessment procedures.

We also note that the International Ethics Standards Board for Accountants (IESBA) recently issued a Consultation Paper: Professional Skepticism – Meeting Public Expectations. We would request that the IAASB consider the responses to this consultation in finalizing the revisions to ED 315.

We support the intention of including a requirement to obtain "sufficient appropriate audit evidence" to provide the basis for the audit opinion by appropriately identifying, assessing, and responding to the risks of material misstatement, however we do not support the use of the term "sufficient appropriate audit evidence" in the context of risk assessment procedures alone. In particular, it is unclear what the consequences may be when complying with the requirements of ISA 500, *Audit Evidence,* where sufficient appropriate audit evidence is used in the context of obtaining reasonable assurance that the risk of an inappropriate opinion being issued has been reduced to an acceptably low level.

Further, the ISAs define sufficiency (of audit evidence) as "the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence." If the sufficiency of audit evidence is affected by the assessment of the risks of material misstatement, it seems somewhat circular to use this as a basis for the identification and assessment of the risks of material misstatement.

We are of the view that terminology similar to that used in Public Company Accounting Oversight Body's (PCAOB) Auditing Standard (AS) 1105[3] of providing "a reasonable basis" would be preferable in referring to the assessment of risks of material misstatement at the financial statement and assertion levels.

Specific Questions

Q5. 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 of 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?

We are of the view that the clear segregation of the components of an entity's system of internal control and the procedures to be performed in respect of each of these components assists with the auditor's understanding of an entity's system of internal control and helps to clarify why that understanding is obtained. We also find the introduction and explanation of "indirect" controls as those controls that likely address risks in the control environment or financial statement level risks, and "direct" controls as those controls that are typically designed to address misstatements at the assertion level for classes of transactions, account balances and related disclosures, helpful.

We would recommend, however, that paragraph A20 of the proposed standard be clarified regarding the extent of the auditor's risk assessment

[3] PCAOB AS 1105, *Audit Evidence*

procedures or that an alternative example is included. As currently drafted, it gives the impression that performing inquiries alone is sufficient, which we do not believe is the intention of this application material.

Overall, we note that the components, other than the information system and communication component are reflective of the principles established in the COSO Framework[4]. The information system and communication component, however, does not reflect the principles established in the related COSO component. This inconsistency in drafting is the source of some confusion and lack of clarity in the requirements related to understanding and evaluating this component.

We are concerned with the proposed requirements in the information system and communication component. Specifically, paragraph 35 requires the auditor to "obtain an understanding of the information system relevant to financial reporting, including the related business processes through understanding how information relating to significant classes of transactions, account balances and disclosures flow through the entity's information system." This assumes that the auditor has already made the determination of which class of transactions, account balance or disclosure is significant and that understanding the business process is determined based on the auditor's risk assessment.

Additionally, the related application material states that understanding the flows of information related to classes of transactions, account balances or disclosures that are not determined to be significant is not required. There may be business processes that do not relate to significant classes of transactions, account balances or disclosures that it is beneficial for the auditor to understand. We are of the view that the focus should first be on gaining an understanding of the business process, which involves gaining an understanding of a transaction from initiation to recording and as such, will likely impact a number of account balances and disclosures, some of which may be significant and some of which may not. We would recommend that paragraph 35(a) of the proposed standard specifically state the understanding of the information system, including the related business processes are in respect of classes of transactions, account balances or disclosures that are expected to be significant to the financial statements.

Further, the nature and extent of the auditor's understanding of each significant class of transactions, account balance or disclosure may be different. For example, the understanding required for a class of transactions may not be the same as that required for an account balance or for a

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[4] Committee of Sponsoring Organizations of the Treadway Commission (COSO): Internal Control – Integrated Framework

disclosure. The proposals do not provide guidance on how the auditor's understanding may need to differ.

We are also of the view that the related application material in this area is somewhat circular in nature and do not believe that merely stating that the process is iterative is helpful.

The Explanatory Memorandum states that the understanding of the entity's system of internal control is integral to the auditor's identification and assessment of the risks of material misstatement and in particular, that it informs the auditor's expectations about the operating effectiveness of controls and the auditor's intentions to test controls. It further states that, as such, it is the auditor's foundation for the assessment of control risk. However, it does not acknowledge nor discuss how understanding the entity's system of internal control provides important information to the auditor, when making an assessment of the risk of material misstatement, on how the entity understands and manages inherent risk.

Paragraph 35(d) of the proposed standard, and related application, includes a requirement for the auditor to understand the entity's IT environment. We are the view that further guidance in the application material would be helpful in situations where the entity uses an "off the shelf" IT package.

b) Have the requirements related to the auditor's identification of the 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?

We agree that the requirements and associated application material related to the auditor's identification of the controls relevant to the audit represents an enhancement on extant ISA 315 (Revised).

However, we note the following:

- Consistent with our response to Question 2, the interaction of paragraph 35 with paragraph 39 of ED 315 results in a lack of clarity regarding controls relevant to the audit; the requirement to understand the information system relevant to financial reporting would appear to negate the requirement to understand only those controls relevant to the audit.
- Paragraph 39(e) of ED 315 requires the auditor to identify controls relevant to the audit that have not been identified by complying with the first four parts of this requirement. This requirement is awkward in its construction and is a "catch-all" requirement that will require significant professional judgment in its application. In comparison to

other parts of this requirement, there is little application material to assist the auditor in how to make the identification. Guidance on how other controls relevant to the audit are determined, including the factors the auditor considers in making the determination, along with practical examples in this area would be helpful to prevent inconsistent application in practice.

- Paragraph 39 of ED 315 also states that "not all controls relevant to financial reporting are relevant to the audit." Examples of such controls would also be helpful.
- The requirement in paragraph 41 of ED 315 needs further clarification to connect the identification of the risks arising from the use of IT to the assessment of the risks of material misstatement relating to the significant classes of transactions, account balances and disclosures. As currently drafted, it leaves the impression that assessing the risks arising from the use of IT is a separate and additional assessment of the risk of material misstatement. The requirement should be clear that this assessment is integral to the identification of significant classes of transactions, account balances and disclosures.

c) Do you support the introduction of the new IT-related concepts and definitions? Are the enhanced requirement 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?

We support the introduction of the new IT related concepts and of the definitions. However, we are of the view that the incorporation of IT requirements throughout the components of internal control results in excessive focus on the IT environment and the controls therein. It impairs the auditor's overall understanding of the IT environment and IT controls and creates the implication that issues with the IT environment or with IT controls, in and of themselves, could cause issues for the component in which it is placed. Further, there is no requirement to document the auditor's understanding of the IT environment or IT controls in such a manner.

As such, we would recommend further clarification related to the extent of the understanding and evaluation of the IT environment required by the proposed standard and of the overlap of the IT environment and IT controls, and the implications thereof, with the business processes to which they relate. Scalability could also be emphasized by providing explicit guidance on how the proposals in this area can be applied to less complex engagements and, at a minimum, what is required of auditors for such engagements.

Q6. 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 are supportive of the requirement to perform separate assessments of inherent and control risk at the assertion level. However, as stated above, we have concerns about when control risk has to be assessed at maximum. Inherent risk and control risk are the entity's risks. As auditors, we may place reliance on the entity's controls to address risks of material misstatement. The requirements in the standard, as drafted, are not allowing for situations where the entity does have controls that are designed and implemented (i.e., reliance on design). Control risk is an entity risk that exists independent of the audit. From a methodology perspective, control risk can be assessed by determining control reliance. Audit procedures to evaluate design, determine implementation, and determine operating effectiveness support the control risk (or control reliance) assessment. Audit sampling theory, including the audit risk model, also supports this approach.

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 introduction of inherent risk factors as a means to assist auditors in making their assessment of the risks of material misstatement. However, we are concerned with the layout of how the factors are separated into specific categories For example, separate categories of complexity, subjectivity and uncertainty have been created. It is not clear why all three categories would be necessary when considering the following:

- The result of complexity and subjectivity is uncertainty.
- A class of transactions, account balance or disclosure may have an identified inherent risk factor of subjectivity but it may also be complex, or vise-versa.
- The difference between the categories of subjectivity and management bias may not always be clear.

Our concern is that auditors will inappropriately focus their attention on the categorization of the inherent risk factors themselves instead of the impact that the inherent risk factors have on the assessment of inherent risk.

The application material focuses heavily on the description or further elaboration of what these inherent risk factors represent. Whilst we agree a more condensed version of this would be necessary to assist auditors in understanding the inherent risk factors, we would also recommend that the application material clarify that the inherent risk factors are a tool to assist auditors in their risk assessment and the categorization of risk factors is neither required to be performed nor documented. This would avoid the impression that the classification of inherent risk factors is an exercise in and of itself. We also note, in paragraph A245 of ED 315, relating to the documentation of the identified risks of material misstatement, the term "higher level" of professional judgment is used. This is not a defined term, and we recommend that this be clarified.

We also note that ED 315 identifies the susceptibility to misstatement due to management fraud or bias as an inherent risk factor. We are of the view that this "inherent risk factor" is incorrectly characterized in ED 315. It mixes the concept of fraud risk and fraud risk factors and does not correctly characterize the events or conditions that indicate an incentive or pressure to perpetrate fraud, provide an opportunity to commit fraud or indicate attitudes or rationalizations to justify fraudulent activities (the "fraud triangle"). We would recommend that, rather than including the susceptibility to fraud as an inherent risk factor, stronger linkage is included to ISA 240 in relation to the auditor's assessment of the risk of material misstatement in this regard.

Conversely, the proposals also introduce a quantitative inherent risk factor for which no further description is provided. It is not clear why the inherent risk factors were expanded from qualitative inherent risk factors to also include quantitative factors, or what would meet the definition of a quantitative inherent risk factor. For example, should this be interpreted to mean that larger accounts are automatically more susceptible to misstatement at the assertion level? What if that account was made up of one single large transaction?

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?

We agree with the concept of a spectrum of inherent risk; however, we are of the view that the current proposals will not assist in achieving greater consistency in the identification and assessment of inherent risk and specifically those risks determined to be significant risks. Firms already identify different levels of risks in their methodologies through, for example, categorizations of low, elevated and high. Such methodologies do not typically require engagement team's risk assessments to be plotted on a spectrum. It is unclear how the revised requirement and related application material is expected to change these categorizations or how the risks are assessed and included in these categories. Further, it is not clear whether the introduction of a spectrum of inherent risk is expected to affect sampling methodologies.

Further, as noted in our response to Question 1 and further expanded on in our response to part e) of this question below, we do not agree that a risk can be determined to be significant based on its likelihood ***or*** its magnitude. If a risk of material misstatement has a high magnitude, but next to no chance of occurring, it does not seem appropriate to characterize this as a significant risk. It will also likely result in increased variation in practice of the identification and assessment of the risks of material misstatement that are determined to be significant, rather than increased consistency. In our view, if the definition of significant risk is to be changed, it should be based on a combination of both its likelihood ***and*** its magnitude.

Further, we are of the view that guidance is needed on how the spectrum of inherent risk will interact with the determination of Key Audit Matters (KAM). For example, could a risk that has been identified as reasonably possible but not be of a high magnitude result in a KAM being identified and communicated?

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?

We are supportive of the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures and their relevant assertions. However, we are of the view that further clarity is required in respect of the following:

- The proposals should clarify that the approach to identifying and assessing risks of material misstatement begins at the financial statement level and with the auditor's overall understanding of the entity and its environment and works down to the significant classes of transactions, account balances and disclosures and their relevant assertions. This approach will focus attention on the significant classes of transactions, account balances and disclosures and the assertions that present a reasonable possibility of material misstatement. As such, it is possible that not every account in the trial balance will be subject to audit procedures.

- The definition of relevant assertions lacks clarity. It equates the concept of "reasonable possibility" with that of "more than remote." We do not believe that this is an appropriate equation. "Remote" and "possible" have distinct meanings in some financial reporting frameworks and even with the use of qualifiers should not be considered to mean the same in all frameworks. We would recommend that the IAASB use only one of these terms and include a definition of that term.

Absent further clarity in these areas, we are of the view that new concepts and definitions will be inconsistently and, maybe inappropriately, interpreted and applied.

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?

In our view, changing the definition of significant risk did not form part of the original objectives of the project. Not only does it change the notion of a significant risk by creating the implication that practically every audit engagement will have at least one significant risk (in addition to those required by ISA 240), it will result in the creation of more issues than simply adding application material to explain the meaning of "a risk of material misstatement that, in the auditor's judgment, requires special audit consideration." For example, it is possible that a risk is identified as being at the upper end of the spectrum of risk, but that it may not require special audit consideration.

Further, as noted above, we disagree with the proposed definition of significant risk being based on the likelihood ***or*** magnitude of the risk of material misstatement.

We are further of the view that the proposed definition of significant risk will result in the following practical implementation issues:

- It will result in a different definition of a significant risk to that of other auditing standards. For example, the definition of significant risk in PCAOB AS 2110[5] is consistent with that in extant ISA 315 (Revised).

[5] PCAOB AS 2110, *Identifying and Assessing Risks of Material Misstatement* paragraph 62

Such differences in definition will result in issues for firms when developing their global methodologies.

- It will result in complications for the audits of financial statements of groups that cross jurisdictions where significant risk is defined differently. Such differences could result in risks being categorized as significant in one jurisdiction but not meeting the definition in another. For example, under the proposed definition, an inherent risk that has a high magnitude but a low likelihood of occurrence, may meet the definition of a significant risk, but because of its low likelihood, may not be determined to be a risk that requires "special audit consideration" and as such not a significant risk under other auditing standards.
- "Close to the upper end of the spectrum" may be inconsistently interpreted by firms and may result in risks of the same likelihood and magnitude being categorized as significant by one firm but not as significant by another.
- The spectrum of inherent risk only contemplates risk at the assertion level and as such does not take into account financial statement level risks, which would also need to be identified and assessed. As currently proposed, application of the proposed definition of significant risk would result in the significant risk of management override of controls, required by ISA 240, being the only financial statement level risk meeting the definition.

Overall, we are of the view that the proposed change in the definition of a significant risk will have a negative impact on audit quality.

Q7. 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 believe that the additional guidance in relation to the auditor's assessment of risk of material misstatement at the financial statement level could be improved by the inclusion of examples of specific financial statement level risks that would affect the assessment of risks at the assertion level and examples of those that would not. Examples of financial statement level risks that could affect the assessment of risk at the assertion level could include uncertainty about the ability of an entity to continue as a going concern or the impact of a business combination. An example of a financial statement level risk that does not necessarily have an impact on the assessment of risk at the assertion level could be the presumed risk of management override of controls, unless a specific risk of management override has been identified and assessed by the auditor.

Q8. 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 do not object to the retention of a stand-back requirement in ED 315, however, we do not believe that a stand-back requirement in either ED 315 or ISA 330[6] is required. We are of the view that the proposed changes in ED 315 will increase robustness of the auditor's performance of risk assessment procedures, which negates the need for a stand-back requirement. However, we are also of the view that there is value to including application material that includes the concepts of considering the appropriateness of the risk assessment. This would promote a principles-based standard and also reinforce that risk assessment is a continuous not a linear processes.

Further, we are of the view that it would be preferable for any such application material to move closer towards the requirements of other standard setters in this area. For example, PCAOB AS 2110 indicates that for classes of transactions, account balances or disclosures that are determined not be significant, the auditor might perform substantive procedures because it may be assessed that there is an unacceptably high possibility that a material misstatement may exist or because the auditor determines that this is an appropriate means of introducing unpredictability.

CONSEQUENTIAL AND CONFORMING AMENDMENTS

Q9. 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)?

We note that no consequential or conforming amendments have been proposed to ISA 200 in respect of the use of "considerations specific to smaller entities." However, the proposed amendment in paragraph A67a uses the proposed new term of "smaller and less complex entities." As such, this is creating inconsistencies rather than addressing them. Further, it does not acknowledge the statement in the Explanatory Memorandum, that considerations relating to smaller and less complex entities may also be applied to larger entities that are less complex.

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?

6 ISA 330, *The Auditor's Responses to Assessed Risk*

We are of the view that paragraph A29a of the proposed conforming and consequential amendments to ISA 330 lacks clarity and would appear to suggest that the performance of control testing in circumstances where substantive procedures alone cannot provide sufficient appropriate audit evidence is optional. This clearly contradicts the requirement in paragraph 8(b) of ISA 330 to perform tests of controls in such circumstances.

We also note that a cross reference in paragraph 10(a) to application material paragraph A29b appears to have been omitted.

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

We would recommend a further review of the ISAs for instances where the "risk of material misstatement" forms part of the requirement or of the application material. We noted that ISA 505[7] paragraph 15 refers to the risk of material misstatement being assessed as "low." We are of the view that this should be changed to "lower" for consistency with ED 315. Further, as part of this review, we would recommend consideration of whether the reference should be to inherent risk rather than the combined assessment of risk of material misstatement.

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

We have no specific comments in respect of the conforming amendments to ISA 540 (Revised). However, we believe that ISA 540 (Revised) may need to be revisited to address the comments raised in connection with ED 315.

Q10. 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?

We do not support the proposed revisions to paragraph 18 of ISA 330. We are of the view that this requirement should not be retained. However, if based on the preponderance of responses, this requirement is retained, we are of the view that application to classes of transactions, account balances or disclosures that are qualitatively material should be deleted. Such a determination would be made as part of the auditor's materiality determination and risk assessment (i.e. it would likely be the risk factor that would make a class of transactions, account balance or disclosure significant).

[7] ISA 505, *External Confirmations*

REQUEST FOR GENERAL COMMENTS

Q11. 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.

As stated in our comments above, we note that the proposals in English are somewhat complex and difficult to interpret. This difficulty is magnified when a standard is being translated into other languages. For example, there is no significant difference between the French translation of the word "significant" and the word "material." Historically, this has not been of particular concern, but given the introduction of the concept of "significant classes of transactions, account balances and disclosures," this similarity has now become more important.

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 are of the view that an effective date of 18 months after the approval of a final ISA would not be sufficient. This is based on the extent of the change that will be required to implement the revised standard. Firms will need to change their respective methodologies, their audit software and tools and provide sufficient training to their staff. Without such actions, the implementation of the new standard may not result in improving the quality of audits and in reality may be detrimental to quality.

When considering an appropriate period for adoption, we note that the standard is currently scheduled to be approved in June of 2019. If this approval does occur as scheduled, we are of the view that an appropriate effective date would be for audits of financial statements for periods beginning on or after December 15, 2021, a year later than that proposed in ED 315. However, if the approval occurs subsequent to June 2019, we are of the view that the effective date should be for audits of financial statements for periods beginning on or after December 15, 2022.