



PAFA

PAN AFRICAN FEDERATION
OF ACCOUNTANTS

BUILDING A BRIDGE TO A BRIGHTER AFRICA

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**The Chairman
International Auditing and Assurance Standards Board (IAASB)**

By email

PREFACE

The Pan-African Federation of Accountants (PAFA), is the continental body representing Africa's professional accountants. Our objective is to accelerate the development of the profession and strengthen the voice of the accountancy profession within Africa and worldwide.

In its unique regional capacity to facilitate PAOs and present a unified position of the profession, PAFA presents below its comments on Exposure Draft ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement* issued by the International Auditing and Assurance Standards Board (IAASB).

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:**

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

PAFA is of the view that the proposed changes and the accompanying flowcharts will augment the risk identification and assessment process. This is based on the belief that the clarification will serve to guide the auditor better in terms of where to direct their focus in their identification and assessment process.

- Will the revisions promote a more robust process for the identification and assessment of the risk of material misstatement and do they appropriately address the public interest issues outlined in paragraph 6 – 28?**

It is PAFA's view that the revisions will indeed promote a more robust risk identification and assessment process which will in turn uphold public interest through improved audit quality.

- Are the new introductory paragraphs helpful?**

PAFA believes that the introductory paragraphs serve to provide a useful indication of the flow of the risk assessment process.

- 2. Are the requirements and application material of ED-315 sufficiently scalable, including the ability to apply ED-315 to the audits of entities with a wide range of sizes, complexities and circumstances?**



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PAFA appreciates the IAASB's point in relation to all standards being applicable to audits of all size and types and consequently agrees with the removal of the "considerations specific to smaller entities" section. It is PAFA's view that this will enhance the application of professional judgement and minimize the bling application of such explicitly stated consideration regardless of complexity. PAFA believes that the inclusion of the introductory paragraph is adequate to achieve the scalability objective.

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? 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 scepticism the necessary guidance?**

PAFA is comfortable with the approach taken with regards to data analytics in recognition of the advancements in technology and their use in the audit process. The examples provided are also useful in providing insight on how the automated tools and techniques are being used without trying to be exhaustive and thus putting the standard at the risk of being dated.

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 identification and assessment of the risks of material misstatement, and do you believe this clarification will further encourage professional skepticism?**

While it is clear to see how the proposals as well the specific reference to obtaining "sufficient appropriate audit evidence" through the performance of risk assessment procedures support and can enhance the exercise of professional skepticism, it is not clear how the clarification will encourage professional skepticism.

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 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?**

While there is consensus that the requirements relating to the auditor's understanding of each component of the entity's system of internal control have been appropriately enhanced and clarified, there is some concerns that wit is not always clear how an understanding should be obtained, i.e. should the auditor always use observation and inspection in addition to inquiry or when would it be a requirement of the auditor to use observation and inspection?



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Another concern relates to the manner in which information system controls (paragraphs 35 to 37), control activities (paragraph 38) and controls relevant to the audit (paragraphs 39 to 42) have been structured:

- Information system controls and control activities are the two components that comprise direct controls and, by their nature, they are very closely related. For example, the flow of information as part of a particular business process, including how transactions are initiated, recorded, processed and corrected, will also encapsulate control activities such as authorisations and approvals, reconciliations and verifications.
- It is peculiar why the control activities component is presented and structured in a different manner compared to any of the other four components. Furthermore, why is it necessary to link controls relevant to the audit primarily to the control activities component and not also to information system controls? To illustrate, it would be possible to also identify the controls listed in paragraph 39(a) to (e) with controls in the information system and communication component.
- The interrelatedness of the information system and communication component, and the control activities component is acknowledged in paragraph A160: "Controls in the control activities component include those controls over the flows of information within the information system relating to significant classes of transactions, account balances and disclosures and the financial reporting process used to prepare the financial statements."
- There are further indications of this interrelatedness (for example, paragraphs A166 and 40) and, hence, that it is more appropriate to assert that controls relevant to the audit are primary controls in the information system and communication, and control activities components (i.e. direct controls).

It is proposed that higher level of clarity may be achieved if the control activities component is presented and structured in the same format as the other components, followed by the "Controls relevant to the audit"-section. The latter being based on the notion that controls relevant to the audit are primarily identified from the direct controls components, namely the information system and communication, and control activities. It may then also be possible to only address the "design and implementation" requirement once, whereas it is now split between paragraphs 36 and 42 (although some thought would need to go into whether the robustness of the auditor's understanding of an entity's direct controls may be compromised).

- b. Have the requirements related to the auditor's identification of controls 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?**

PAFA agrees that the requirements related to the auditor's identification of controls relevant to the audit have been appropriately enhanced and clarified and that it is clear how controls relevant to the audit are identified, including for audits of smaller and less complex entities. There is, however, a concern over the open ended requirement for the auditor to identify controls that he/ she believes are appropriate to evaluate (when identifying controls relevant to the audit) in that it may create inconsistent application thus presenting a challenge from an external monitoring/ inspections point of view.



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A proposed solution to this is to define the terms ‘controls relevant to financial reporting’ and ‘controls relevant to the audit’ in order to enhance the consistent interpretation and application of these concepts.

- c. **Do you support the introduction of 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 IT on the identification and assessment of the risks of material misstatements?**

PAFA supports the introduction of IT-related concepts and definitions, however, it is PAFA’s view that the 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 require further enhancement as it is currently not entirely clear how they fit together.

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

- a. **Do you support separate assessments of inherent and control risks at assertion level, and are revised requirements and guidance appropriate to support the separate assessments?**

PAFA supports the separate assessments of inherent and control risks at assertion level and is comfortable that the revised requirements and guidance are appropriate to support the separate assessment.

- b. **Do you support the introduction of 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?**

PAFA agrees with the introduction of concepts and definitions of “inherent risk factors” to help identify risks of material misstatement and assess inherent risk and believes that sufficient guidance has been provided to explain these risk factors and how they are used by the auditor in the risk assessment process.

There is, however, scope to further refine the definition of inherent risk factors so as to include the notion that the inherent risk factors may not necessarily be restricted to only the five main factors that have been identified; i.e. it may also include other risk factors such as those mentioned in paragraph A6. The following wording is suggested:

- **Inherent risk factors** – Characteristics of events or conditions that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty, or susceptibility to misstatement due to management bias or fraud and other risk factors as may be applicable in the circumstances.



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- c. **In your view, will the introduction of ‘spectrum of inherent risk’ (and related concepts of assessing the likelihood of occurrence and magnitude, of a possible misstatement) assist in achieving greater consistency in achieving greater consistency in the identification and assessment of risks of material misstatements, including significant risks.**

It is PAFA's view that the introduction of ‘spectrum of inherent risk’ (and related concepts of assessing the likelihood of occurrence and magnitude, of a possible misstatement) will assist in achieving greater consistency in the identification and assessment of risks of material misstatements, including significant risks.

- d. **Do you support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and the relevant assertions? Is there sufficient guidance to explain how they are determined (i.e. an assertion is relevant when there is reasonable possibility of occurrence of a misstatement with respect to that assertion), and how they assist the auditor in identifying where risks of material misstatement exist?**

PAFA supports the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and the relevant assertions.

- 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?**

PAFA supports the revised definition, and related material, on the determination of ‘significant risks’ on the basis that it appropriately describes how a significant risk should be determined therefore making it more conceptually sound.

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?**

PAFA supports the requirement to assess risks of material misstatement at financial statement level with a clear link to the overall responses to such risks in ISA 330. PAFA also agrees that it is appropriate to determine how risks at the financial statement level may affect the assessment for risks of material misstatement at the assertion level, and, furthermore, that the auditor may decide during the assessment of risks of material misstatement at assertion level that some risks relate to more than one assertion and update the identification of risks at financial statement level.

PAFA agrees that the auditor’s assessment should, among others, be influenced by his/ her understanding of the entity’s system of internal control. It is suggested that the application material in paragraphs A218-A219 be expanded to specifically relate risks at the financial statement level to the auditor’s understanding of indirect controls, similar to how direct controls primarily address potential risks of material misstatement at the assertion level.



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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?**

PAFA supports the proposed stand-back requirement as it views it as a mechanism to further enhance the risk assessment process.

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)?**

Yes these are appropriate

- 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?**

Yes, the changes are appropriate.

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

Yes, the changes are appropriate

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

Yes, the changes are appropriate.

10. **Do you support the proposed revisions of 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?**

Yes, PAFA believes this is appropriate as it clarifies that when the ISAs refer to material it means in quantitative or qualitative respects.



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Request for general comment

11. In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters 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**

None noted

- 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 the final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide sufficient period to support effective implementation of the ISA.**

Based on the resource constraints that PAFA member bodies have, any translation undertaken by affected regional bodies would require a longer time frame, making the 18 months after approval too early for effective implementation.