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ED 315 – Request for comment

Thank you for seeking comment on the clarity, understandability and practicality of application of the requirements and related application material of ED-315.

I have two overarching comments regarding the revised ED-315. These two comments are based on my perspective as a director and user of auditing services.

1. Use of risk management frameworks by companies

My primary observation in reviewing ED-315 is that it has not kept pace with developments in the business environment. The procedures in paragraph 18 regarding inquiry should be replaced by review of the company's risk registers, which provides evidence of risk assessment in all areas of the business. Inquiry is a "fall-back" procedure only. The review of the entity's risk assessment process (paragraphs 29-31) requires higher profile as the first point of reference. The audit guidance material (paragraphs A115-A119) should be expanded so that auditors ***expect*** to examine the risk management framework adopted by a company, and then internal controls as part of risk mitigation. ED-315 seems to suggest that a company *may have* a formal process for risk assessment. In contrast, corporate risk assessment practice is more likely to focus on an established framework that has been adapted for use by the company.

References to the "auditor's understanding of the system of internal control" including information system components seems to encourage narrow thinking and assessment of risk by auditors. Reference to "understanding the control environment relevant to financial reporting" is also somewhat spurious in a digital age of integrated systems. Even the most basic software packages such as MYOB or QuickBooks provide integrated accounting systems. As an audit and risk committee member, I have raised questions about the risk assessments presented by auditors (both Big 4 and mid-tier) concerning how their risk assessments align with the company's risk registers. A focus on "internal control" seems to direct auditors to the reporting systems, without a proper understanding of where those reporting risks lie in the context of corporate risk.

Typically, all corporate risks will have financial consequences and impact qualitative materiality, if they are not mitigated to the extent where the residual risk is acceptable. In the public interest, auditors should have a deeper awareness of how all corporate risks may impact the financial report.

Directors have primary responsibility for a company including both company performance and risk mitigation. ISO 31000 – *Risk Management* provides principles, framework and a process for managing risk. It is used by all types of organisations of all sizes and activities. Further, professional and tertiary education (such as MBAs, governance and other director courses) are well developed in risk management education. The use of risk management frameworks such as ISO 31000 or similar, have been used by companies increasingly over the past decade, and formal risk assessment by corporates is now well-established practice. Further, the COSO Internal Control Framework was superseded by the COSO Enterprise Risk Management – Integrated Framework more than a decade ago.

Providing oversight and critique of management's implementation of established frameworks such as ISO 31000 is useful for directors in their own assessment of risk and to mitigate director liability. ISO 31000 provides a basis for comprehensive risk assessment beyond the accounting systems and includes consideration of strategic, operational, compliance, financial and reporting risk.

An external auditor's review of a company's risk registers would provide audit evidence of corporate culture, risk appetite, diligence (or lack thereof) and qualitative materiality factors in the evaluation of corporate risk. The review of the company's risk registers would also assist in the auditor's application of ISA 250 *Consideration of Laws and Regulations in an Audit of Financial Statements*. Given the multitude of laws, regulations and other contractual obligations for which companies must demonstrate compliance, a compliance register has become a fundamental component of a company's risk register.

2. Use of data analytics

As a director, I observe that auditors are still requesting information to examine (relatively) small samples, when they could be examining the whole population. Further, when auditors present requests for information in their client packages to promote audit efficiencies, any "stumble across" issues are unlikely to be identified. When we consider the over-arching objective of the IAASB is public interest, I question whether it is acceptable in today's business environment for an auditor to ***not*** examine the whole population for anomalies and unusual items, when there are tools which make this process entirely accessible.

There are various audit tools available that enable a whole population of transactions or balances to be examined for significant or unusual items. Larger audit firms may use their own proprietary software to produce a summary report/dashboard of items needing further examination in the audit, whereas smaller firms may purchase audit software such as IDEA, CaseWare Analytics or TeamMate Analytics to achieve similar results (note: these audit tools are included as examples only in no particular order and with no endorsement). In addition, there are various tools in Excel that enable data analysis. 2018 Excel can be used to import populations and characteristics up to more than one million rows and more than 16,000 columns i.e. more than adequate for examining and sorting data in low cost audits. In very small companies, the whole population can be examined by simply reviewing transaction reports. When auditors have used audit software to examine whole populations, their reports to management on matters arising from the audit are far superior to the more 'traditional' management letter and the value of an audit is clearly visible.

There are arguments about costs of audit software being prohibitive, but audit software for deeper examination is needed to keep pace with business development and public expectations. I suggest it is time for audit expertise and audit teams to be structured in a different way, to promote more efficient and effective audit procedures. As a minimum, I recommend that the audit guidance in ED-315 should be encouraging the use of audit tools to examine the whole population, with prerequisite audit evaluation of controls to ensure the population is complete.

Responses to the request for comment in Section 4 of the Explanatory Memorandum

Question 1 – No significant matters arising

Question 2 – The requirements are scalable.

Question 3 – The guidance regarding automated tools could be improved. Refer to discussion above.

Question 4

The use of the term ‘sufficient appropriate audit evidence’ in the context of risk assessment procedures requires more guidance. Currently auditors document the risk assessment procedures that have been carried out.

- Does a requirement for ‘sufficient appropriate audit evidence’ indicate that something beyond documentation of risk assessment procedures is needed?
- If management information is used for preliminary analysis, does this new requirement indicate that management information will not comprise ‘sufficient appropriate evidence’ unless it is first verified?
- Similarly, do sources for industry or competitor information need to be verified before used to assess risk?
- Will auditors expect a different type of information from management or those charged with governance as a consequence of this change?

If the use of this term is intended to ‘raise the bar’ in the quality of matters documented as risk assessment procedures, then this matter needs both debate and guidance. In particular, the change in terminology should not impact on the way directors and management operate.

Questions 5 - 8

The approach outlined in the exposure draft draws on a somewhat dated approach to assessing risk and the audit approach does not leverage from the significant progress in risk management practice over the past decade. In particular, an assessment of qualitative materiality can be derived from a review of a company’s risk registers. Refer to discussion above.

Question 9 - No matters arising in the context of the current drafting.

Amendments may not be complete to the extent they are impacted by better articulation of the auditor’s examination of a company’s risk management procedures in further revision to ED-315.

Question 10 - No significant matters arising.

Question 11 - No comment

Please feel free to contact me regarding matters arising from this submission.

Yours faithfully

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