

ISA 315 (Revised) – Exposure Draft

- Q&A Webinar
- October 3rd, 2018

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Exposure Draft
July 2018
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International Standard on Auditing

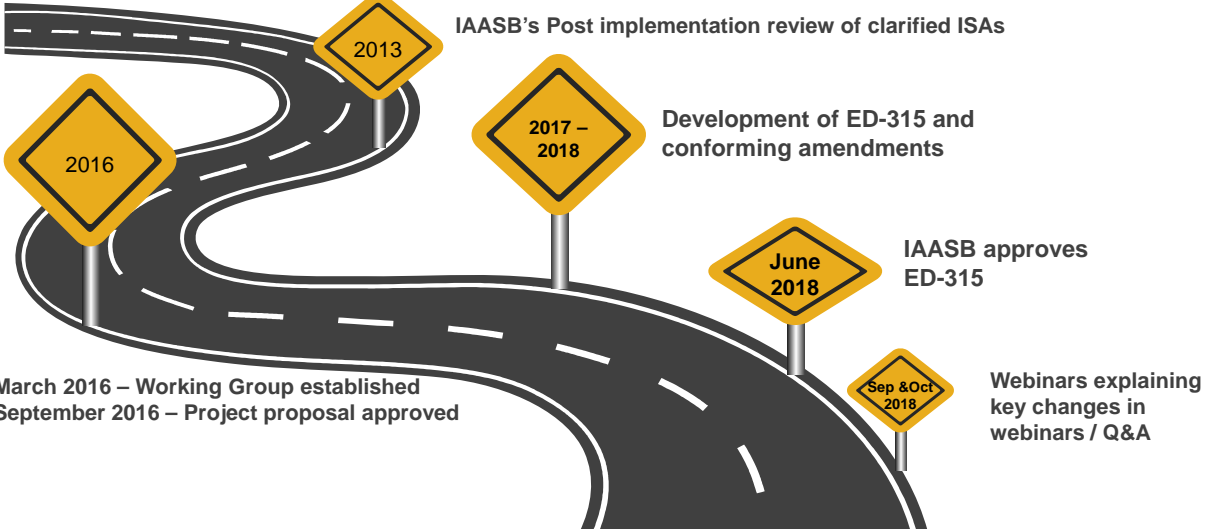
Proposed International Standard
on Auditing 315 (Revised)

Identifying and Assessing the
Risks of Material Misstatement
and
Proposed Consequential and
Conforming Amendments to
Other ISAs





ISA 315 (Revised)—The Journey So Far



2013
IAASB's Post implementation review of clarified ISAs

2017 – 2018
Development of ED-315 and
conforming amendments

June 2018
IAASB approves
ED-315

Sep & Oct 2018
Webinars explaining
key changes in
webinars / Q&A

2016

2016
March 2016 – Working Group established
September 2016 – Project proposal approved

Nov 2018–June 2019 development of final proposals

ISA 315 (Revised) – Questions

- Acronyms used:

Terms:	Acronym:
International Standards on Auditing	ISA
ISA 315 (Revised) Exposure Draft	ED-315
ISA 315 (Revised) Explanatory Memorandum	EM
Evaluating the design of a control and determining whether the control has been implemented	D&I
Financial reporting framework	FRF
Significant classes of transactions, account balances and disclosures	SCOTABD

ISA 315 (Revised) Q&A – Introductory Paragraphs

- ED-315 now has new introductory paragraphs setting out the key concepts in the proposed standard. Since these paragraphs are separate from the requirements, what is the authority of these paragraphs (i.e., do these paragraphs carry the same authority)?

ISA 315 (Revised) Q&A - Overarching

2. In the Explanatory Memorandum (EM) and the project proposal, it says that the Board did not intend to change the fundamentals of the audit risk model. The EM refers to scalability and consistency of identifying significant risks as the key areas where stakeholders felt the risk assessment model needed to be improved. The Exposure Draft, however, proposes quite significant changes to the risk assessment process - introducing new concepts, logic and requirements that impose a much more directive thought process. Recognizing that changing the fundamentals of the risk assessment model will have a significant effect on methodologies and audit software, and therefore will potentially be disruptive with possible negative impact on audit quality at least during transition, why does the Board believe that this nature and extent of the proposed changes are necessary to address the issues that had been identified? **Did the Board consider alternative ways to address stakeholders' issues that did not involve fundamentally changing the risk assessment model in extant ISA 315?**

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ISA 315 (Revised) Q&A – Scalability

3. The application material of extant ISA 315 (Revised) included separate paragraphs on 'considerations specific to smaller entities.' these paragraphs are not in the ED - what is the approach in ED-315?
4. Please clarify the scope of 'smaller and less complex' in the context of ED-315. For example, what about larger and less complex entities?

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ISA 315 (Revised) Q&A – Definitions

Controls

5. The new definition includes that controls could be ‘implied through actions and decisions.’ Could these type of controls be identified as controls relevant to the audit?

6. What is the distinction between ‘controls’ and ‘application controls’?

ISA 315 (Revised) Q&A – Definitions

Significant risk

7. What is the relationship between ‘likelihood’ and ‘magnitude’ in determining whether any assessed risk of material misstatement is a significant risk? For example, for any relevant assertion, can the related risk of material misstatement be a significant risk where:
 - The likelihood of misstatement is towards the lower end of the spectrum of inherent risk (but there is still a reasonable possibility of misstatement that is material); and
 - The magnitude of potential misstatement is towards the upper end of the spectrum of inherent risk

ISA 315 (Revised) Q&A – Automated Tools and Techniques

8. What is meant by the term ‘automated tools and techniques’ and how is this different from data analytics?
9. For purposes of the auditor’s risk assessment procedures, what is the difference between the use of automated tools and techniques and analytical procedures in accordance with ISA 520 – *Analytical Procedures*?
10. Does ED–315 require the use of automated tools and techniques when performing risk assessment procedures?
11. If the auditor uses automated tools and techniques, what is the auditor’s responsibility in relation to the accuracy and completeness of the source data?

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ISA 315 (Revised) Q&A – Definitions

Relevant assertions

12. What is the relationship, if any, between:
 - Reasonable possibility and
 - More than remote and
 - Reduce audit risk to an acceptably low level (included in definition of detection risk – ISA 200)

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ISA 315 (Revised) Q&A – Inherent Risk Factors

13. What is the purpose of the inherent risk factors?
14. Why are the inherent risk factors in ED–315 *different* to the inherent risk factors in ISA 540 (Revised) – *Auditing Accounting Estimates and Related Disclosures*?
15. Please clarify how the inherent risk factors affect the auditor’s understanding of the applicable FRF
16. The ISA introduces the concept of inherent risk factors, one of which is that an account balance, class of transactions or disclosure may have a quantitative inherent risk factor. This would imply that all large account balances, classes of transactions or disclosures would have a level of inherent risk associated with them, which would appear to contradict the concept of a ‘material only’ account balance, class of transaction or disclosure introduced in paragraph 52 of the proposed standard. Please clarify how this should be interpreted.

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ISA 315 (Revised) Q&A – Risk Assessment Procedures

17. The proposes standard uses the term “sufficient appropriate audit evidence” in the context of risk assessment procedures. This term has a specific meaning in the standards. Please could you explain how this would be implemented, specifically in the context of paragraph 6 of ISA 500, *Audit Evidence*?

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ISA 315 (Revised) Q&A – Understanding the System of Internal Control

18. One of the key areas in the extant ISA that practitioners felt required clarification was the question of "how much is enough" in obtaining an understanding of controls, particularly in relation to control activities. This is key to scalability and efficient and robust audits. The overriding aim has now been set as needing to obtain sufficient understanding to have "sufficient appropriate audit evidence". Yet it seems open-ended and circular, given that para 39 (e) imposes a judgment on the auditor to identify and evaluate those controls that, in the auditor's professional judgement, are appropriate "to identify and assess the risks of material misstatement". It is not clear the basis on which the auditor makes that judgment, yet it seems critical to the determination of when the auditor has obtained "sufficient appropriate audit evidence" as a basis for the auditor's risk assessment. Can you explain how the proposed revisions provide the needed clarification of how much understanding is needed?

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ISA 315 (Revised) Q&A – System of Internal Control

19. If the auditor knows they want to take a fully substantive approach to the audit, why is it necessary to obtain an understanding of the components of the system of internal control / controls?

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ISA 315 (Revised) Q&A – Control Environment

20. Can the auditor obtain the required understanding of the control environment through inquiries only?
- Para. 36 of the EM states that the nature, timing and extent of risk assessment procedures are matters of professional judgment, and based on the auditor's determination as to what will provide sufficient appropriate audit evidence for the basis for the identification and assessment of the risks of material misstatement.
 - Para. A108 of ED-315 states: 'Audit evidence for the auditor's understanding of the control environment may be obtained through a combination of inquiries and other risk assessment procedures.'

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ISA 315 (Revised) Q&A – Information System and Communication

- ED-315 para. 35 requires the auditor to understand how information relating to SCOTABDs flows through the entity's information system
- However, the auditor only determines SCOTABDs and their relevant assertions based on identified risks of material misstatement in accordance with para. 46 of ED-315

Question:

21. Please clarify the nature and extent of the determination of SCOTABDs for purposes of para. 35 of ED-315.

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ISA 315 (Revised) Q&A – Information System and Communication

22. Paragraph 36 of the proposed standard requires the auditor to evaluate the design of the information system controls relevant to financial reporting by understanding how information relating to significant classes of transactions, account balances and disclosures flow through the entity's information systems. Is this requiring:

- The auditor to evaluate the entire information system, including the business processes for all identified risks?
- The auditor to understand controls for every significant class of transactions, account balance and disclosure?

ISA 315 (Revised) Q&A – Information System and Communication

23. What is the difference in the work effort between:

- ED-315 para. 36: Evaluating the design of information system controls relevant to financial reporting, by understanding how the matters in paragraph 35(a)–(d) are addressed by the entity, and implemented; and
- ED-315 para. 42: For each control identified as relevant to the audit, evaluate the D&I

ISA 315 (Revised) Q&A – Control Activities

24. Is it possible to not have any controls relevant to the audit?
What impact would this have on the rest of the audit?

ISA 315 (Revised) Q&A – D&I of Controls

25. Paragraph 39 (e) indicates that it is in the auditor's judgement to identify and evaluate D&I of controls when it is needed to identify and assess risk or to design further audit procedures. The application material is focused on how that would benefit the auditor in designing further audit procedures. Therefore:
- Could you please explain, how identifying controls (and evaluating their D&I) would IDENTIFY risk(s) of material misstatement?
 - Could you please explain, how identifying controls (and evaluating their D&I) would ASSESS risk(s) of material misstatement (other than control risk for assertion level risks of material misstatement)?
 - Could you provide a common situation when it would be appropriate NOT to identify and evaluate D&I of controls under paragraph 39(e) given that the wording in the requirement says it can assist in identifying as assessing risks of material misstatement?

ISA 315 (Revised) Q&A – Control Deficiencies

26. In a primarily substantive audit approach, the identification of controls relevant to the audit may be limited, and accordingly, the auditor may not identify any control deficiencies within the system of internal control.

Is there an obligation on the auditor to perform additional work in order to identify control deficiencies (such as ‘missing’ controls) based on the requirements of ED–315 para. 43?

ISA 315 (Revised) Q&A – Controls Relevant to the Audit

27. Consider the following scenario:

- The auditor adopted a substantive audit approach, and therefore did not perform any tests of the operating effectiveness of controls
- The auditor identified controls relevant to the audit and performed D&I in accordance with the requirements of ED–315
- The auditor did not identify any control deficiencies in accordance with paragraph 43 of ED–315

Questions:

- i. How does the scenario affect the assessment of control risk in accordance with the requirements of
 - ED–315?
 - Extant ISA 315 (Revised)?
- ii. What are the objectives or benefits of identifying controls relevant to the audit and performing the related D&I procedures?

ISA 315 (Revised) Q&A – Controls Relevant to the Audit

28. Are there circumstances where D&I procedures are sufficient to test the operating effectiveness of the related control(s)?
29. Is there an expectation that the auditor will always identify
- IT applications relevant to the audit?
 - General IT controls relevant to the audit?
30. ED–315 para. A181:
- ‘When an entity uses an IT application that is reputable, widely-used and considered reliable, is unable to change its programming, and maintains hard-copy accounting records, the auditor may determine that there are no IT applications relevant to the audit’*
- How does the auditor assess ‘reputable’ given that very well known software vendors have released software that did not operate as stated or expected?

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ISA 315 (Revised) Q&A – Identifying and Assessing Risks of Material Misstatement

31. ISA 200 defines a risk of material misstatement as the risk that the financial statements are materially misstated prior to audit. ISA 200 explains that one component of that risk at the assertion level is inherent risk, which is defined as the susceptibility of an assertion about a class of transactions, account balance or disclosure to a misstatement that could be material. The proposed new risk assessment asks the auditor to identify the risks of material misstatement and to determine whether they exist at the financial statement level or at the assertion level. If assertions are, in effect, a way of considering what could go wrong in a line item, class of transactions or disclosure, it would seem that consideration of assertions is part of identifying risks of material misstatement in the first instance. The auditor is then subsequently asked to identify the significant classes of transactions, account balances and disclosures, and relevant assertions - both of which depend on whether there is a reasonable possibility of occurrence (which is, in effect, a risk assessment) - before making an assessment of identified risks. The proposed logic as reflected in the requirements seems circular and it seems to prescribe a particular thought process rather than outcome oriented requirements. Can you explain why the Board felt these changes were needed and which issues they are intended to address?

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ISA 315 (Revised) Q&A – Identifying and Assessing Risks of Material Misstatement

32. In determining the risks of material misstatement at the assertion level, is the expectation that the account balances and significant classes of transactions be identified at the trial balance level or at a financial statement line item level?

ISA 315 (Revised) Q&A – Spectrum of Risk

33. The proposed standard introduces the concept of a spectrum on inherent risk that allows auditors to categorize the risk of material misstatement along that spectrum. Paragraph A225 indicates that the categories may be described in a numerical way (e.g., a scale of 1-10), or based on the relative placement on the spectrum (e.g., high, medium, low). Did the task force perform any outreach to determine if a scale of 1-10 is a method that has been or could be practically used by firms? If a relative placement method is used, how would this differ from or drive change for firms that already use a relative scale, for example, existing methodologies that use categories of low, elevated and high?

ISA 315 (Revised) Q&A – Identifying and Assessing Risks of Material Misstatement

34. The separate identification of inherent risk and control risk is mostly consistent with the recently approved ISA 540 (Revised). The Exposure Draft, however, puts a discrete focus on assessing control risk and includes a rather complicated explanation about when control risk can be assessed at less than maximum, depending on whether or not the auditor intends to test the operating effectiveness of controls. An ISA audit is not designed to provide a basis for an opinion on internal control. Therefore, the auditor does not really assess "control risk" per se. Rather having made the assessment of inherent risk, the auditor decides on the approach to obtain evidence in response, which can be through a combination of substantive procedures and obtaining evidence about the operating effectiveness of relevant controls. Has the Board considered structuring the revisions to be better aligned with how an auditor typically thinks about controls in designing an audit plan for an audit where there will not be a separate report on internal controls?

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ISA 315 (Revised) Q&A – Significant Risks

35. The proposed standard introduces a new definition of significant risk. What does the Task Force [IAASB] believe will be the impact on the number and type of risks that are identified by auditors as being significant risks? Has consideration been given to the impact on audits of group financial statements where one or more components are located in jurisdictions where the definition of significant risk remains the same as that in extant ISA 315 (Revised)?

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ISA 315 (Revised) Q&A – Stand-Back Requirement / ISA 330 Para 18

36. Why is it necessary to use the terms ‘quantitatively or ‘qualitatively’ in the context of materiality – does it not already include both aspects?
37. Please provide an example of a class of transaction, account balance or disclosure that may be quantitatively or qualitatively material, but may not be identified as a SCOTABD
38. For an account balance that is NOT identified as a SCOTABD, but is quantitatively or qualitatively material, what is the nature of the required substantive audit procedures. For example, do the substantive procedures have to address all the assertions?
39. Paragraph 52 of the proposed standard introduces the concept of balances that are “material only.” Please can you clarify whether the expectation is that this assessment is made at the financial statement line item and disclosure level?

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ISA 315 (Revised) Q&A – Documentation

40. What are the nature and extent of documentation requirements in relation to the inherent risk factors when:
 - Understanding the FRF;
 - Identifying and assessing inherent risk (including significant risks); and
 - Identifying and assessing risks of material misstatement
41. What are the documentation requirements of the stand-back requirement? There are concerns that this requirement implies documenting ‘reasons’ why auditors did not identify any inherent risks, whereas it may be highly judgmental in many instances.

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ISA 315 (Revised) Q&A – Documentation

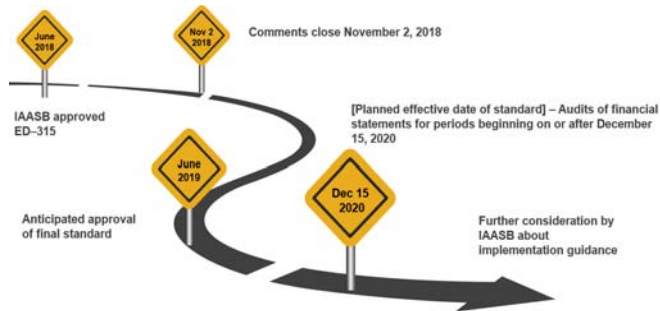
42. The proposed standard includes a number of qualitative inherent risk factors to consider when assessing inherent risk at the assertion level. Please indicate whether the intent of the proposed standard is for the auditor to identify and document the specific inherent risk factor driving the likelihood and magnitude of a misstatement or whether the intent is for the auditor to use the described inherent risk factors as a tool to assist in the inherent risk assessment.

ISA 315 (Revised) Q&A – Guidance

43. The flowcharts are very helpful – will these be included in the application material of the standard?
44. The length and complexity of the standard is a concern – does the IAASB plan other implementation guidance or initiatives going forward?

ISA 315 (Revised) – Way Forward

- Way forward
 - Submit comments by no later than **November 2, 2018**
 - Respond to questions – if not supported, please provide your reason
 - If principles or concepts are supported, please state this fact



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