

Comments from the ASB's AU-C 315 task force in red below.

ISA 315 (Revised)¹—Issues and Recommendations

Objective of the IAASB Discussion

The objective of this agenda item is to obtain the Board's views on the second draft of the proposed revisions to ISA 315 (Revised) as set out in **Agenda Item 3-A (Introductory Paragraphs and Requirements) and 3-B (Application Material)**.

I. Structure of this Paper and Format of the IAASB Discussion

1. This paper sets out Task Force views about proposed changes to ISA 315 (Revised) in both the requirements and related application material. The proposed changes are presented as follows:
 - **Agenda Item 3-A:** sets out the Task Force's views on all the proposed changes to the requirements, revised for comments from the December 2017 IAASB discussions (marked to extant ISA 315 (Revised)).
 - **Agenda Item 3-B:** sets out proposed changes to the application material, revised for comments from the December 2017 IAASB discussions (marked to extant ISA 315 (Revised)). In considering the application material, the Board is asked to note that the considerations specific to public sector will be updated after planned outreach with public sector representatives in March 2018. The Task Force will continue to consider the scalability of the standard as it further refines the proposed changes (scalability is discussed further in paragraphs 11 and 47–49 of this paper). In addition, the Task Force continues to consider the application material related to information technology considerations as well as general IT controls.
2. In addition, in working through the changes to the standard, the ISA 315 Task Force (the 'Task Force') will continue to consider whether additional non-authoritative guidance should be developed (e.g., for small and medium practices (SMPs) to illustrate what needs to be done, by way of examples).
3. The Task Force has to still consider conforming amendments arising from the proposed changes to ISA 315 (Revised), which will be presented at the June 2018 IAASB meeting for discussion, with the exception of conforming amendments relating to ISA 330,² paragraph 18 (see paragraph 44 of this paper). The Task Force has identified likely conforming amendments to ISA 200³ (also see paragraph 10 of this paper), ISA 330 and ISA 540 (Revised)⁴ to date in its work to revise ISA 315 (Revised). In relation to conforming changes to ISA 540, the Task Force will work with the ISA 540 Task Force with regard to sequencing of the changes as the ISA 540 Task Force finalizes that standard.
4. The Task Force's activities including outreach and coordination with other IAASB Task Forces or Working Groups, can be found in Appendix 1 to this paper. Matters that crossover the project to revise ISA 540,

¹ International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.

² ISA 330, *The Auditor's Responses to Assessed Risks*

³ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

⁴ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

including the outcomes of the joint meetings with the ISA 540 Task Force, can be found in paragraph 5, and coordination with the Data Analytics Working Group (DAWG) can be found in paragraphs 50–52 of this paper.

5. The Task Force continues to coordinate with the ISA 540 Task force as both projects progress. In particular, matters of coordination the Task Forces have focused on include:
 - Alignment of the use of inherent risk factors, and the requirements about obtaining an understanding of the system of internal control (see paragraph 37 of this paper), within each standard.
 - Spectrum of risk—the ISA 315 Task Force continues to work through how this can be explained in ISA 315 (Revised) (see further explanation in paragraphs 8–9 of this paper). As noted in Agenda Item 2, paragraphs 11 to 12, the ISA 540 Task Force will also continue to monitor the changes and align changes to ISA 540 (Revised) accordingly.
 - Conforming amendments that may still be needed once ISA 540 is finalized and the ISA 315 (Revised) Exposure Draft is published—in the coordinated work being undertaken by the two Task Forces it is expected that the conforming changes will be minimal but the ISA 315 Task Force still needs to further consider any changes that may be needed to ISA 540 once it is finalized. These matters will be brought to the Board for discussion in June 2018.

II. Matters Relating to the Proposed Changes in ISA 315 (Revised)

6. This section describes significant changes made since the December 2017 Board Agenda Papers.

Title, Scope, New Introductory Paragraphs and Objective (Requirements: paragraphs 1 through 3⁵ of ISA 315 (Revised))

7. There have been no changes made to the title, scope and objective since previously presented.
8. ISA 315 (Revised) substantially builds off the concepts in ISA 200, which defines and describes audit risk, the risks of material misstatement (including that they may exist at the overall financial statements level or the assertion level), describes the concepts of control risk and inherent risk, and describes that some risks are higher than others (i.e., introducing the concept that there is a 'spectrum of risk'). ISA 330 requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level to design and perform further audit procedures to address assessed risks of material misstatement at the assertion level, and further describes what this involves.
9. To provide context for the requirements and guidance in ISA 315 (Revised) relating to the identification and assessment of the risks of material misstatement, the Task Force had referenced certain paragraphs from ISA 200 and ISA 330 in the revised application material proposed to the Board in December 2017. The Board found these generally to be useful in explaining key concepts. However, some concerns were expressed about the nature of some of these paragraphs as it appeared in some cases that those paragraphs were addressing matters within the scope of ISA 330 (which deals with how to respond to the identified risks of material misstatement). Accordingly, the Task Force has removed this text from the application material and instead reorganized this material as introductory paragraphs to ISA 315 (Revised). The Task Force is of the view that this provides context for the requirements and application

⁵ The effective date of the revised standard will be further considered at the time of exposure.

material, in particular introducing some of the concepts that are key to understanding the standard, such as 'spectrum of risk.'

10. The Task Force has not yet specifically considered conforming or consequential amendments to ISA 200 beyond the prior acknowledgement that ISA 200, paragraph A42,⁶ will require amendment to clarify that ISA 315 (Revised) requires separate assessments of inherent risk and control risk. The paragraphs of ISA 200 that deal with audit risk and related concepts are included in Appendix 3 to this paper for the Board's reference. The Task Force is interested in Board views as to whether the draft introductory paragraphs draw an adequate connection to these concepts in ISA 200 and whether any further consequential amendments to ISA 200 should be considered by the Task Force beyond those planned for paragraph A42.
11. In developing the introductory paragraphs, the Task Force also has the view that it is important to emphasize the scalability of the standard in the way it is applied, i.e., that the nature and extent of what is required to be performed in ISA 315 (Revised) depends on the nature and complexity of the entity, as well as the entity's system of internal control, including its IT environment.

⁶ The project to revise ISA 540 has also proposed amendments to this paragraph (see Agenda Item 2)

Matter for IAASB Consideration

1. The Board is asked for its views on the new introductory paragraphs, in particular whether these new paragraphs are appropriate in making the connection between ISA 315 (Revised) and the concepts in ISA 200 and requirements for responding to assessed risks of material misstatement in ISA 330.

a. Some concern that scope of changes has exceeded the initial intent of the project, which was to focus on:

- Clarifying the auditor's responsibility w/ respect to internal control
- Providing updated/additional guidance on IT controls
- Clarifying guidance regarding significant risks

Concern relates to whether other changes being proposed are sufficiently important to warrant change, given the challenges auditors will be facing with recent standards related to auditor's reports, revenue, leases, and credit losses.

b. Also some concern about level of duplication from ISAs 200 and 330 in the scope section; recommend replacing with references to where this information is located in those sections. The ASB TF would also encourage a reference to the requirements in ISA 240, either in this section or in the "Risk Assessment Procedures and Related Activities" section beginning at paragraph 5; given the importance of risks of fraud, we believe ISA 240 should be referenced in the requirements, in addition to the discussion in application guidance.

c. Paragraph 1D – delete "relative to other risks of material misstatement"; determination of significant risks in a particular audit shouldn't depend on relative level of other risks.

Definitions

Task Force Views on the Proposed Changes

Controls (Definition: paragraph 4(ca) of ISA 315 (Revised); Application Material – paragraphs A0b–A0c of ISA 315 (Revised))

12. To address concerns about describing policies as including "informal expectations" the Task Force has revised the definition to recognize that policies may include statements that may be documented, explicitly stated in communications or implied through actions and decisions, which may make it clearer that policies have authority even if delivered through some kind of communication or action (i.e., still recognizing that it does not have to be formal written policies). The revised definition reflects the description of 'controls' in the *2013 Committee of Sponsoring Organizations Internal Control – Integrated Framework (COSO Framework 2013)*.

13. Explanatory material has also been added to clarify that procedures may be enforced through the actions permitted by the design of the IT application used by the entity.

General Information Technology (IT) Controls and Application Controls (Definition: paragraph 4(a) and 4(caa) of ISA 315 (Revised))

14. In response to Board comments at the October and December 2017 meetings, the Task Force has proposed adding a definition of General IT Controls. The definition included in Agenda Item 3-A is

taken from the extant Glossary. As this definition refers to “application controls” and this term is also used in the application material of ISA 315 (Revised), the Task Force is of the view that including the definition of “application controls in information technology” from the Glossary would also be helpful. The Task Force however is of the view that both of these definitions may benefit from modernization. If the Board supports the addition of these terms to the definitions, the Task Force will seek to update them to more closely reflect current state IT environments.

Qualitative Inherent Risk Factors (QIRFs) (Definition: paragraph 4(cb) of ISA 315 (Revised); Application Material – paragraph A0d–A0g of ISA 315 (Revised))

15. In further considering how to incorporate the QIRFs into the requirements and application material, the Task Force has considered in greater depth what these represent and how they are used in the process of identifying and assessing the risks of material misstatement. In addition, the Task Force has deliberated on how other factors (that affect inherent risk but were not included in the QIRFs) are included in the auditor’s considerations when gathering information and identifying and assessing the risks of material misstatement.
16. In the view of the Task Force, inherent risk factors are characteristics of events and conditions that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Inherent risk factors can either be quantitative (numerical) or qualitative. The current definition, and use, of QIRFs does not take account of the quantitative aspects of such events and conditions. Accordingly the definition for QIRFs (and use throughout ISA 315 (Revised)) has been changed to “inherent risk factors” to facilitate the auditor’s consideration of the full range of possible types of inherent risk factors that may be identified as characteristics of events and conditions. New application material to the definition provides further examples of quantitative and qualitative factors. In addition, the Task Force has also revised Appendix 2 that sets out examples of events and conditions that may indicate risks of material misstatement to place these examples in the context of the inherent risk factors. Further consideration will still be given to whether additional matters need to be added to Appendix 2 to better reflect the changes that have been made to the definition of inherent risk factors. In the remainder of this paper we refer to inherent risk factors rather than QIRFs.
17. The Board has also continued to question whether susceptibility to fraud should be described as an inherent risk factor, and the Task Force continued to deliberate this. In particular, concern has been raised that:
 - Fraud risk factors relate to both inherent risk and control risk but the inherent risk factors) are required to be used in the identification of inherent risks; and
 - There does not appear to be a clear linkage between susceptibility to fraud as an inherent risk factor and the procedures performed in accordance with ISA 240 to evaluate fraud risk factors in relation to the identification of risks of material misstatement related to fraud.
18. In its deliberations, the Task Force agreed that identified and assessed risks of material misstatement the assertion level include risks due to error and risks due to fraud. In further considering what creates susceptibility to risks due to fraud, the Task Force has agreed that ‘behavioral’ aspects (of those responsible for the preparation of the financial information) should also be considered (the other four QIRFs are attributable to the entity or the nature of the item and do not affect management behavior).

19. In regard to management behavior, the Task Force concluded that an inherent risk factor should capture characteristics of events or conditions relating to classes or transactions, account balances or disclosures that provide an incentive or pressure or an opportunity for intentional or *unintentional* management bias, believing this to be consistent with the concept of inherent risk. Accordingly, the Task Force has agreed that ‘susceptibility to fraud’ should be changed to ‘susceptibility to management bias,’ which broadens the risk factors to incorporate characteristics of events or conditions that interact with management behaviors that can affect risks of material misstatement due to error or fraud. Further application material has been added to clarify that this inherent risk factor relates to the characteristics of events or conditions that indicate an incentive or pressure, or create an opportunity, for management to not maintain neutrality in preparing financial information. The Task Force is of the view that this factor overlaps and is not in conflict with the use of fraud risk factors, in the context of the fraud triangle, in identifying risks of material misstatement due to fraud.
20. The application material has been enhanced to reflect the matters noted above, and has also been added to, to clarify that the inherent risk factors do not operate independently but rather interact with one another. For example, complexity and subjectivity are strongly influenced by change and uncertainty. The Task Force has also reconsidered how the inherent risk factors have been described in the application material and changes made accordingly.

Relevant Assertions (Definition: paragraph 4(cc) of ISA 315 (Revised))

21. In response to December 2017 Board comments, explanatory material has been elevated into the definition of relevant assertions to clarify the meaning of ‘reasonable possibility.’
22. The Task Force also agreed it would be helpful to emphasize that the determination of a relevant assertion is based on inherent risk (i.e., controls are not taken into account). In light of this addition, and upon further reflection, the Task Force is of the view that the definition of relevant assertion is consistent with that of the US Public Company Accounting Oversight Board (PCAOB). The Task Force believes that the difference in wording between the proposed ISA 315 (Revised) definition and the corresponding PCAOB definition is useful to draw out the relationship between a relevant assertion and a significant class of transactions, account balance or disclosure.

Significant Risks (Definition: paragraph 4(e) of ISA 315 (Revised); Application Material – paragraph A0h of ISA 315 (Revised))

23. The definition of significant risk has been amended to clarify that the inherent risk factors affect the likelihood of a misstatement occurring as well as the potential magnitude of that misstatement. This brings consistency with the revised requirement that addresses the auditor’s assessment of inherent risk in paragraph 26.

Matters for IAASB Consideration

2. The IAASB is asked for its views on:
 - (a) Whether the definition of ‘general IT controls’ and ‘application controls in information technology’ should be included in ISA 315 (Revised) and the Task Force’s intention to seek to modernize these definitions;
 - (b) The changes to the qualitative inherent risk factors, including the broadening to susceptibility to management bias as well as broadening to inherent risk factors to incorporate quantitative aspects; and **The ASB TF is supportive of broadening the concept of inherent risk factors.**

However, while inclusion of the concept of management bias broadens the concept in terms of incorporating error as well as fraud, the TF believes it is not a substitute for including fraud risks in the notion of inherent risk factors, as it excludes susceptibility to theft, and may not fully incorporate susceptibility to intentional misstatement. The TF also raised the question of whether/how management bias differs from subjectivity.

- (c) Other changes to the definitions and related explanatory material as described above.
- a. Paragraph 4(aa) ([assertions](#)) – Referencing comment under question 1 above, ASB TF believes current definition is well understood and doesn't require revision.
 - b. Paragraph 4(cc) ([relevant assertions](#)) – The ASB TF agrees with this definition, but believes it may result in a significant change in practice in some circumstances. Application guidance illustrating assertions that may not be relevant for a given material account balance, and the auditor's thought process in reaching that conclusion, would be very helpful.
 - c. Paragraph 4(e) ([significant risk](#)) – first bullet – “the likelihood of a misstatement occurring or and the magnitude of potential misstatement”; ASB TF believes both must be present for a risk to be a significant risk.

3. Are there any other changes to the definitions that the Board believes is necessary, including whether there are other terms that need to be defined?

Requirements—Risk Assessment Procedures and Related Activities (Requirements: paragraphs 5–10 of ISA 315 (Revised); Application Material – paragraphs A1–A24 of ISA 315 (Revised))

Task Force Views on the Proposed Changes to the Requirements

24. The Task Force has further considered the use of the phrase of 'sufficient and appropriate' throughout the proposals made in December 2017 in light of Board concerns about the use of these terms. The Task Force continues to have the view that it is important in paragraph 5, which described the various aspects of obtaining an understanding, to clarify *why* this understanding is obtained. In further considering the 'why,' the Task Force agreed that the purpose of obtaining the required understanding of the various aspects is to provide sufficient appropriate audit evidence for the identification and assessment of risks. This further confirms that risk assessment procedures performed provide audit evidence, which is consistent with ISA 500,⁷ which has been highlighted in the application material.
25. Further to this change, the Task Force also amended the requirement in paragraph 9 that addresses the use of audit evidence from prior periods to emphasize that the auditor needs to evaluate whether such evidence remains relevant and reliable to be used as audit evidence in the audit for the current period.
26. With regard to the application material, the Task Force has:
- Highlighted the iterative nature of the risk identification and assessment process.
 - Highlighted that the depth of understanding required will vary according to the nature and circumstances of the entity.

⁷ ISA 500, *Audit Evidence*, paragraph A10 states that audit evidence is obtained... from performing risk assessment procedures; and further audit procedures...

- Clarified the various sources of information available to the auditor, including data provided by the entity.
 - Provided further guidance about the auditor's considerations about information obtained from client acceptance and continuance, and other engagements performed for the entity being audited, in relation to the identification and assessment of risks of material misstatement.
27. Further explanation about the use of automated tools and techniques can be found in paragraphs 50–52 of this paper.

Matter for IAASB Consideration

4. The IAASB is asked for its views on the proposed changes to the requirements and application material relating to risk assessment procedures and related activities.
- a. ASB TF is supportive of the flow of the requirements, but some concern about how understandable it is given the number of complex, interrelated concepts involved; suggest an overview of the requirements be provided to auditors (an example for discussion purposes is at the end of this document), either as part of the standard, in an appendix, or in other guidance issued by the IAASB.
 - b. Paragraph 5 – in the wording following the bullets, “sufficient to provide a reasonable basis sufficient appropriate audit evidence”; ASB TF doesn't believe “sufficient appropriate audit evidence” is an appropriate concept during the risk assessment phase of the audit.
 - c. Paragraph 6 – one could conclude, from this paragraph and the application guidance in paragraph A5, that inquiry is sufficient to obtain an understanding of certain aspects of the entity's system of internal control. Some concern was raised at the ASB TF as to whether this conclusion would be consistent with the requirement to maintain professional skepticism throughout the audit. We recommend (not unanimously though) a requirement be included that, for aspects of the system of internal control the auditor deems it necessary to understand in order to carry out the auditor's responsibilities in the risk assessment process, inquiry alone is not a sufficient procedure.

The Understanding of the Entity and Its Environment, and the Applicable Financial Reporting Framework (Requirements: paragraphs 11–11A of ISA 315 (Revised); Application Material – paragraphs A24a–A49f of ISA 315 (Revised))

28. To respond to Board comments from the December 2017 Board meeting, the Task Force has made changes to paragraph 11 of ISA 315 (Revised) as follows:
- Restructured the paragraph to make clear that the understanding is obtained to provide an appropriate basis for the auditor to understand the classes of transactions, account balances and disclosures to be expected in the financial statements.

- Clarified that the understanding required of the applicable financial reporting framework, and of changes to accounting policies, is in the context of the nature and circumstances of the entity and its environment.
 - Clarified how the inherent risk factors are addressed when obtaining an understanding of the entity and its environment and the applicable financial reporting framework. In December 2017 this was presented as a separate sentence at the end of the requirement but concern was expressed that it was not clear what needed to be done. In the view of the Task Force, the auditor considers the characteristics of events and conditions (i.e., the inherent risk factors) as the understanding of the entity and its environment and of those events and conditions is obtained in conjunction with the auditor's consideration of how the requirements of the applicable financial reporting framework apply in that context. Understanding how the inherent risk factors affect the susceptibility of an assertion to misstatement enables the auditor to consider which assertions about which classes of transactions, account balances or disclosures may be subject to potential risks of material misstatement, and to help identify and assess the risks of material misstatement. Accordingly, the auditor's consideration of the applicable financial reporting framework has been enhanced to take into account events or conditions that may indicate risks of material misstatement and how such events or conditions are subject to, or affected by, the inherent risk factors.
29. In relation to the application material, the Task Force has:
- Moved certain matters related to the auditor's understanding of the entity and its environment to a new appendix (Appendix 1) consistent with its December 2017 proposals.
 - Provided further guidance about the depth and breadth of understanding required, as well as provide context for why the understanding is obtained (i.e., to help the auditor develop expectations for the identification of potential risks of material misstatement).
 - Further emphasized the importance of professional skepticism in obtaining an understanding of the entity and its environment.
 - Further clarified matters related to the entity's business model and business risks.
30. Further explanation about the use of automated tools and techniques when obtaining an understanding of the entity and its environment can be found in paragraph 50–52 of this paper.

Matter for IAASB Consideration

5. The IAASB is asked for its views on the proposed changes to the requirements and related application material regarding the auditor's understanding of the entity and its environment, and applicable financial reporting framework, including:
- (a) The drafting of the revised requirements set out in paragraphs 11 and 11A of ISA 315 (Revised).
 - (b) The application material set out in paragraphs A24a–A49f of ISA 315 (Revised), as well as whether there are other matters that should be included in the application material.
 - a. Paragraph A44 – in referencing the risk of fraud, it may be helpful to specifically mention the risk of management override of controls here.
 - b. Paragraph A49a – 2nd bullet, 1st subbullet – The ASB TF wasn't sure whether "significant and unusual classes of transactions, account balances and disclosures" is a concept in the ISAs (as distinguished from "significant

and unusual transactions”). We recommend that be researched, and if it isn't, substituting “significant and unusual transactions” in this subbullet.

The Required Understanding of the Entity's Internal Control (Requirements: paragraphs 12–21B of ISA 315 (Revised); Application Material – paragraphs A50–A109g of ISA 315 (Revised))

31. In response to December 2017 Board comments for the Task Force to consider the appropriate placement of the requirements related to the auditor's identification of controls relevant to the audit and the evaluation of the design and implementation of the controls, the Task Force has:
- Created a separate section that addresses “Controls Relevant to the Audit”, that includes paragraphs 20-21B.
 - Added Paragraph 13 to highlight that the performance of the requirements in the “Controls Relevant to the Audit” section are necessary to the auditor's understanding of the system of internal control (i.e., paragraph 13 together with paragraph 12 highlight all requirements that comprise the auditor's understanding of the system of internal control).
32. The Task Force has further considered how any identified deficiencies for each of the indirect aspects (i.e., the control environment, risk assessment process and monitoring process) should be considered and aligned the respective requirements in each component accordingly. The articulation of the relevant requirements have also been made consistent with the way the requirements are set up in ISA 265.⁸
33. With regard to understanding the entity's risk assessment and monitoring processes, the Task Force continues to believe that it is important to understand these processes, even if they are not formalized. In particular, in smaller entities management may have less formalized processes in place to consider how the entity's risks may identified and addressed, and controls and processes monitored. However, concern had been expressed by the Board about how this had been expressed in the draft discussed in December 2017. Changes have therefore been made to focus on the nature of the processes, including the formality of such processes, and the application material further enhanced in order to evaluate whether the entity's processes are appropriate to the nature, size and circumstances of the entity (highlighting that there may be less formality in the case of smaller, non-complex entities).
34. The Task Force has clarified certain aspects of obtaining an understanding of the information system, including:
- Clearly separating the requirement to understand the flow of transactions and information in paragraph 18(a), from the requirement to understand the accounting and other supporting records in paragraph 18 (b).
 - Clarifying the requirement in paragraph 18 (d) to be an understanding of the IT environment, which includes the understanding of the IT applications and underlying IT infrastructure. Clarifications have also been made in the application material.
 - Introducing a requirement in paragraph 18A to evaluate the design of the information system and to determine whether it has been placed in operation. This requirement recognizes that evaluating the design and implementation of the policies and procedures that define the flows

⁸ ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

of information and the financial reporting process within the information system, should be differentiated from the evaluation in paragraph 21B of individual controls, primarily controls over the information system, that are identified as relevant to the audit. Application material has been added to address techniques for performing this evaluation (for example, by undertaking a walk-through or using automated techniques).

35. With regard to control activities, the Task Force has further clarified its thinking related to the understanding of the component. It is the view of the Task Force that, because this component primarily comprises controls over the information system (including application controls and general IT controls), the understanding of the control activities component is captured in the auditor's process to identify the controls relevant to the audit within the component and to evaluate their design and implementation. Paragraph 19A has been updated accordingly to clarify this thinking.
36. With regard to the types of controls in the control activities component, these have been relocated to the application material to provide supporting guidance on the types of controls that may exist and to inform the auditor's identification of those relevant to the audit. The Task Force will continue to consider how this guidance corresponds to the categories of controls set out in other frameworks.⁹
37. With regard to the requirements within the newly created 'controls relevant to the audit' section, the Task Force has:
 - Updated the application material to support each of the requirements in paragraph 20. Ongoing coordination with the ISA 540 Task Force will assist in determining the need for any further guidance related to accounting estimates.
 - Reinstated and updated the extant requirement related to understanding risks arising from the entity's use of IT. The Task Force has done so taking into consideration the December 2017 Board comments that greater clarity and supporting guidance were needed related to the condition in the proposed requirement to identify general IT controls relevant to the audit (i.e., "based on the auditor's understanding of the risks related to IT"). Upon reflection, the Task Force believes a discrete requirement to identify the risks arising from IT may assist in addressing scalability in the auditor's identification of general IT controls; this requirement can facilitate a risk-based approach based on the nature and complexity of the entity's IT environment. For example, for small entities with unmodified packaged software, the risks arising from IT may be acceptably low, in which case there may not be general IT controls relevant to the audit, particularly when the auditor does not intend to test the operating effectiveness of any application controls.
 - Clarified the requirement in paragraph 21B to evaluate the design and implementation of controls relevant to the audit, in particular to clarify the meaning of "relating controls to what could go wrong at the assertion level." The Task Force is of the view that this requirement involves mapping the individual controls relevant to the audit to the potential risks of material misstatement that each control was designed to address, and that this exercise supports the auditor's ability to evaluate the design of the control in the context of the related risks. Accordingly the term "what could go wrong" has been replaced with "potential risks of material misstatement."

⁹ For example, the 2013 COSO Framework sets out the types of controls in this component as including authorizations and approvals, verifications, physical controls, controls over standing data, reconciliations and supervisory controls.

38. The Task Force has reinstated the explicit requirement for the identification of risks arising from IT in paragraph 21. If the Board is supportive of the Task Force direction, the Task Force will seek to provide supporting application material with a focus on scalability. In addition, the Task Force plans to develop application material, using the assistance of an IT audit specialist, for each of the criteria that drive general IT controls relevant to the audit in paragraph 21A.
39. Changes have also been made to the application material as follows:
- The description about 'limitations of internal control' and various other matters related to the components of internal control have been moved a new appendix in line with the December 2017 Task Force proposal to do so (Appendix 3 related to understanding the entity's internal control).
 - Enhancements have been made to the application material relating to the control environment to emphasize that deficiencies in the control environment may lead to risks of material misstatement at the financial statement level.
 - Some additional guidance has been added relating to the auditor's understanding of IT. As noted above, the Task Force intends to pursue the development of further guidance in support of the requirements in paragraph 21 and 21A.
 - Application material has been added to clarify the reasons for the auditor's evaluation of the design and implementation of controls relevant to the audit. This includes the influence of these procedures on the auditor's identification and assessment of risks of material misstatement, including as well as on the design and performance of further audit procedures.

Matter for IAASB Consideration

6. The IAASB is asked for its views, based on the changes explained above, on the following matters:
- (a) Is it clear, for each component of internal control, what is required for the auditor to obtain the relevant understanding, including how that understanding is obtained?
- a. The ASB TF had some concern about the operability of paragraph 16, particularly in entities with informal risk assessment processes. We suggest instead requiring the auditor consider how a pattern of risks that appear not to have been identified by management may impact the auditor's assessment of the risks of material misstatement (this may be an opportunity to note the iterative nature of the risk assessment process, as noted in paragraph A1).
- b. More broadly, there was some level of concern about the requirements to evaluate components of the system of internal control in paragraphs 14A, 17 and 18A, as such evaluation appears to go beyond the auditor's responsibility to opine on the financial statements, and it's not clear that the required procedures provide an adequate basis for such evaluation. We instead recommend following the requirements for the monitoring element in paragraphs 17A and 17B, whereby the auditor obtains an understanding of the element (sufficient to provide a reasonable basis for the identification and assessment of risks of material misstatement, as noted in response (b) to question 4 above), and communicates any significant deficiencies

- identified in the process of obtaining that understanding, but is not required to evaluate the element.
- c. Paragraph 14 – application guidance on how to determine which aspects of the control environment are “relevant to financial reporting” would be helpful, and would contribute to scalability.
- (b) Is it clear when ‘controls relevant to the audit’ are required to be identified, and what procedures are required to be performed in relation to these controls?
- a. The ASB TF recommends paragraph 20 or application material related thereto provide guidance on when “controls relevant to financial reporting” may not be “relevant to the audit.” Paragraph A100 mentions duplicative controls as a potential example, but it isn’t clear if it’s the only example. Given the special meaning of “relevant” in the context of “relevant assertions” and “controls relevant to the audit”, it may be helpful to define “controls relevant to financial reporting.”
- b. Paragraph A100 discusses multiple controls that achieve the same objective; we believe it would also be helpful to mention that, in many instances, multiple controls may be necessary to provide reasonable assurance of preventing or detecting material misstatement with respect to a particular relevant assertion, to reinforce the “individually or in combination with other controls” point in paragraph 20.
- c. Some additional application guidance in or near paragraph A100 would also be helpful to assist the auditor to determine the extent to which the auditor needs to evaluate controls relevant to the audit, specifically making the point that, once the controls evaluated would, if operating effectively, provide reasonable assurance of preventing or detecting material misstatement, or has concluded that there are no such controls for a particular relevant assertion, no further evaluation of controls is necessary for that relevant assertion.
- (c) Whether the Board agrees with the reinstatement of the requirement to identify risks arising from IT, with related application material.
- (d) The drafting of the requirements set out in paragraphs 12–21B of ISA 315 (Revised). Paragraph 18(a) - the ASB TF talked through some initial confusion about the conundrum that relevant assertions (and therefore significant classes of transactions) are defined in terms of the likelihood of material misstatements, yet obtaining an understanding of the information system related to such classes of transactions is a step in the process of identifying risks of material misstatement. It may be helpful to include application guidance related to this paragraph that references paragraph A1’s observation that risk assessment is an iterative process, in that preliminary judgments (or hypotheses) are made about which classes of transactions contain assertions with a reasonable possibility of material misstatement, and those judgments are revisited as information about those classes is obtained.

- (e) The application material set out in paragraphs A50–A109g of ISA 315 (Revised), in particular the guidance in relation to general IT controls, as well as whether there are other matters that should be included in the application material?
- a. Paragraph A88(a) appears to be the only place in which the entity's internal control related to fraud risk is mentioned; the ASB TF would recommend that be more prominently highlighted in the requirements or application material, perhaps with a reference to the guidance in ISA 240.
 - b. Paragraph A89(b) – "...in some entities such as smaller owner-managed entities, risks are not managed through an established risk assessment process but through direct personal involvement in the business, and may therefore be appropriate." Is the meaning here that the risks may be appropriate, or that management's process may be appropriate? If the latter, recommend changing to "and the process may therefore be appropriate."
- (f) Whether there are any other matters or concerns related to the auditor's understanding of the entity's system of internal control?

Identifying and Assessing the Risks of Material Misstatement (Requirements: paragraphs 25–31 of ISA 315 (Revised); Application Material – paragraphs A121a–A151 of ISA 315 (Revised))

Task Force Views on the Proposed Changes to the Requirements

40. In light of the new concepts being introduced, the Task Force continues to work through the process to identify and assess the risks of material misstatement, in particular how to articulate this process within the standard so that it is able to be effectively applied by auditors from different sized firms, and so that there is a more consistent approach to identifying and assessing risks, in particular significant risks. The Task Force will also continue to consider application material as appropriate to support the revised requirements.
41. Paragraphs 25 through 26 of Agenda Item 3-A set out the Task Force's view about how the process of identifying and assessing risks of material misstatement may flow. In particular, the Task Force believes that based on the information gathered in understanding the entity, the auditor makes a 'preliminary' identification of significant classes of transactions, account balances and disclosures, which is required to be made before consideration of any controls, and iteratively seeks to confirm this initial identification as the process proceeds. Application material has been added to further explain the flow, including how the inherent risk factors impact the assessment of risks. Also, further application material has been developed to assist with the determination of significant risks (i.e., those risks on the highest end of the spectrum of inherent risk).
42. In relation to the assessment of control risk, a stronger link back to the work performed in relation to D&I has been made, with enhanced application material to further explain how the D&I work interacts with the auditor's assessment of control risk. The Task Force has also simplified the requirement to make clear that if the auditor is not intending, or not required, to test the operating effectiveness of controls, that control risk will be assessed as maximum. This allows auditors who intend to perform a primarily substantive audit not to have anything further to do in relation to controls (although it is likely to impact the nature and extent of substantive procedures to be performed).

43. The Task Force has continued to deliberate the requirement in ISA 330, paragraph 18 to design and perform substantive procedures on material balances irrespective of the assessment of the risk of material misstatement. The Task Force continues to consider how this interacts with the new requirement for the auditor to identify the significant classes of transactions, account balances and disclosures, and their relevant assertions. In the view of the Task Force, the concept of 'materiality' relates to the information needs of users. The concept of 'significance' relates to the risks. For classes of transactions, account balances and disclosures that are identified as 'significant,' these would always be material as they are likely to be 'relevant assertions' which, by definition, means there is more than a remote possibility (before consideration of controls) of a misstatement that is material. In such cases, the auditor would already be required to identify and assess the risks at the assertion level related to these significant classes of transactions, account balances or disclosures, and respond accordingly in accordance with paragraphs 7 and 8 of ISA 330.
44. The Task Force also agreed that there could be some (likely rare) cases where a class of transactions, account balance or disclosure could be material but was not identified as significant, and therefore that there would not automatically be a requirement to perform further audit procedures. However, because the amounts reported are material, the Task Force believes that the auditor should perform further audit procedures to address 'what could go wrong' in relation to assertions about classes of transactions, account balances or disclosures. Identifying what could go wrong would also assist the auditor with focusing on appropriate further audit procedures. Accordingly, the Task Force has agreed that the current requirement in ISA 330, paragraph 18, should therefore remain, subject to proposed changes as follows:

ISA 330: *The Auditor's Responses to Assessed Risks*

Requirements:

18. Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each class of material transactions, account balance, and disclosure that is quantitatively or qualitatively material. (Ref: Para. A42–A47)

45. In considering these matters, the Task Force also agreed that ISA 315 (Revised) should facilitate the auditor's identification of classes of transactions, account balances and disclosures that are quantitatively or qualitatively material but have not been identified as significant. Accordingly, a new requirement has been added to require the auditor to identify these and reconfirm that there are no relevant assertions for these classes of transactions, account balances or disclosures. In the view of the Task Force, this will also help make the link to ISA 330 paragraph 18.
46. With regard to the application material for ISA 330, paragraph 18, the Task Force will consider whether other changes are needed in light of Board discussions on matters set out in paragraphs 43 to 45 above.

Matter for IAASB Consideration

7. The IAASB is asked for its views regarding the requirements to identify and assess the risks of material misstatement, including inherent and control risks. In particular, the Board is asked for views about:
- (a) The requirements in paragraphs 25 through 26 of **Agenda Item 3-A** and whether they are clear, and whether there is sufficient application material to support auditors in implementing these requirements? **Paragraphs 25 through 26 discuss (in part) identifying risks of material misstatement at the assertion level; while implied, we recommend these paragraphs explicitly state "at the relevant assertion level".**

(b) The other requirements set out in paragraphs 27–31 of ISA 315 (Revised).

~~(b)a.~~ The ASB TF agrees with the requirements in paragraph 30B, and agrees material accounts without relevant assertions are uncommon in practice. However, the TF is concerned that, even if the auditor concludes after applying paragraph 30B that no relevant assertions have been identified, ISA 330 paragraph 18 still requires further audit procedures be performed, as this seems to fly in the face of the process described in ISA 315. We recommend this requirement in ISA 330 paragraph 18, and the related application guidance in ISA 330 paragraph A42, be revisited, given the proposed revisions to the risk assessment process in ISA 315.

b. While not directly relevant to ISAs, the AICPA Sampling Audit Guide notes that the auditor might accept a slightly lower confidence level based on evaluation of the design and implementation of controls. This appears consistent w/ ISA 530, Appendix 3, factor 3, but an ASB TF member questioned whether paragraph 30A would preclude it. We would recommend the IAASB TF discuss that notion as a possible way to enable auditors to “claim some credit” based on D&I, and explore whether its use is limited to sampling or may have broader application.

(c) The application material set out in paragraphs A121a–A151 of ISA 315 (Revised), as well as whether there are other matters that should be included in the application material.

(d) Whether there are any other matters or concerns related to the auditor’s identifying and assessing the risks of material misstatement?

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Scalability of ISA 315 (Revised)

47. The Task Force continues to consider how to make the standard scalable to a wide variety of entities, all with different circumstances and complexities, while keeping the standard principles-based and able to be effectively implemented.
48. The Task Force has agreed (as with other IAASB projects currently underway) that scalability applies to all sized entities. It is the level of complexity in the nature of the entity and its financial reporting that is the driver of scalability. For example, there may be small entities that have complexities in their business model or their financial reporting, and may therefore require a more robust risk assessment process. Accordingly, and based on direction received from the Board in the December meeting, the Task Force has removed the “considerations specific to smaller entities” throughout the standard. However, many of the matters previously in these sections have been retained and built into the text of the standard as appropriate. In doing so, the Task Force has introduced contrasting examples in certain cases for larger or more complex entities. In addition, as the Task Force has been developing new, and enhancing, application material, it has been mindful of providing scalability aspects as appropriate. The Task Force plans to continue to identify areas of the application material where scalability guidance can be included, particularly as it relates to an entity’s use of IT and the effect on general IT controls relevant to the audit.
49. The following sets out the paragraphs where the Task Force has the view that scalability has been included:

Agenda Item 3-A: Paragraph reference and summary of content (Introductory paragraphs)

1H – 1I	Emphasizing that the size and complexity of the entity may affect the risks of material misstatement and the controls necessary to address those risks.
Agenda Item 3-B: Paragraph reference and summary of content (Application material)	
A24a	Describing the depth of the auditor's required understanding of the entity and its environment – this will vary according to the nature and circumstances of the entity.
A16	Explaining how analytical procedures as a risk assessment tool are scalable: <ul style="list-style-type: none"> - For a less complex entity, the auditor may use a simple spreadsheet to compare information from an interim or month end period with balances from prior periods. - For a more complex entity, the auditor may extract data from the entity's information system, and further analyze this data by using visualization techniques.
A24	Providing guidance where an engagement team discussion may not be possible, for example, where an engagement is carried out by a single partner.
A31	Emphasizing that the auditor's understanding of the entity's organizational structure and ownership is dependent on the particular circumstances.
A31d, A49f	Providing guidance on the consideration of an entity's objectives, strategy or business model for smaller or less complex entities.
A50a, A53	Clarifying that the way in which internal control is designed, implemented and maintained, varies with an entity's size and complexity.
A80a	Explaining the nature of the control environment within smaller entities, and the possible consequences for the auditor.
A80 b–c	Describing the nature & extent of audit evidence for elements of the control environment in smaller entities.
A89	Clarifying that smaller or less complex entities may not have established a formal risk assessment process, and the consequences for the auditor.
A89 b–d	Highlighting that the evaluation of the appropriateness of the entity's risk assessment process is a matter of judgment based on the nature, size and complexity of the entity and that the absence of an established risk assessment process may be appropriate, depending on the circumstances.
A89j	Clarifying that in smaller entities, management's monitoring of control is often accomplished by the owner-manager's close involvement in operations and there may not be any other monitoring activities.

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A89k	Emphasizing that even for some larger entities, there may not be a distinct process for monitoring the system of internal control.
A99i	Explaining that smaller entities may be limited in the extent to which segregation of duties is practicable, and the consequences thereof.
90c, A92c	Describing the nature of the required understanding of the information system, and related business processes relevant to financial reporting, in smaller entities.
A97	Clarifying that the communication of financial reporting roles and responsibilities within smaller entities may be less structured and formal.
A99 a–b	Explaining the nature and extent of control activities in smaller entities
A125d	Acknowledging that, in relation to audits of smaller, non-complex entities, a greater proportion of assessed risks are likely to be at the lower end of the spectrum of inherent risk.
A150 a–b	A reminder that the control risk assessment remains at the maximum level when the auditor does not intend to test the operating effectiveness of controls that address the assessed inherent risks.
A153	Emphasizing that the nature and extent of audit documentation may differ for entities with uncomplicated businesses and processes relevant to financial reporting.

Matter for IAASB Consideration

8. The Board is asked for its views on:
- (a) Building the current matters applicable to “considerations specific to smaller entities” into the text of the application material as relevant.
 - (b) The paragraphs set out in the table in paragraph 49 above, and whether these paragraphs adequately address how to implement the standard to entities with different complexities and circumstances? The ASB TF would recommend paragraph A153 contain a link to the guidance in ISA 230 paragraph A7, which indicates it is unnecessary for the auditor to document separately matters for which compliance is demonstrated by documents included within the audit file, for example, in the context of consideration of inherent risk factors (i.e., documenting the process, but not necessarily documenting and disposing of every inherent risk factor identified).
 - (c) Whether there are other specific areas that the Task Force should consider to further show the adaptability of the standard to entities with differing complexities and circumstances? **Paragraph A109(g) – the ASB TF (or at least its chair) continues to believe there are instances, e.g., involving segregation of duties and automated controls, in which the auditor, in evaluating the design and implementation of controls, thereby also tests their operating effectiveness. In those instances, it would seem to be permissible to reduce control risk. We recommend this point be included in**

application guidance, to help the auditor better understand the scalability of the requirements related to obtaining an understanding of internal control.

Data Analytics

50. The Task Force has, and will continue to, consider how the evolving use of automated tools and techniques could be presented in ISA 315 (Revised) to better reflect current practice for using these tools and techniques in identifying and assessing the risks of material misstatement. In working with the DAWG on relevant guidance and examples to be included, the Task Force has remained mindful of focusing on the use of data analytics as it relates to ISA 315 (Revised). The DAWG will continue to further explore other data analytics matters which have broader implications for ISAs than just ISA 315 (Revised).
51. For the purposes of ISA 315 (Revised), the DAWG has worked with the ISA 315 Task Force on application material to be included in the ISA 315 (Revised) Exposure Draft that relates to the use of data analytics in the risk assessment process. Examples and other application material related to Data Analytics were discussed by the ISA 315 Task Force at its January meeting. During this meeting the following paragraphs were identified and content specific to data analytics have been included in the application material of ISA 315 (Revised):

Application material paragraph ref:	Paragraph:
A2	Emphasizing that technology may be used on large volumes of data, which may result in evidence that informs the identification and assessment of risks of material misstatement.
A4b	Clarifying that the auditor may use automated tools and techniques, including for analysis, recalculations, re-performance or reconciliations.
A16 & A31	Describing how automated tools or visualization techniques may be used as risk assessment procedures.
A96b	Explaining the option to use automated techniques to assist in confirming that the information system has been placed into operation.
A100g	Describing that automated tools may be used to understand the nature and extent of journal entries
A150g	Clarifying that automated techniques may be used to confirm whether all significant classes of transactions and account balances have been identified by, for example, analyzing types of transactions and their volume.

52. The ISA 315 Task Force plans to work with the DAWG to obtain their insights on further enhancements to these examples, or opportunities for other examples in the application material, prior to June 2018.

The following sets out matters for consideration relating to the work of the DAWG, and has been prepared by that group for discussion with the IAASB:

53. In developing the relevant application material for the ISA 315 Task Force's discussion, the DAWG considered issues around the current use of the term 'data analytics,' as well as whether a definition for the term 'data analytics is needed, and provided those views to the ISA 315 Task Force. Definition and Use of the Term 'Data Analytics.'
54. The definition of Data Analytics was discussed by the DAWG during the development of the request for input¹⁰, and various existing definitions were reviewed. The request for input did not specify or recommend any one definition, but instead used a description for purposes of the request for input which drew heavily on the AICPA definition which is as follows:

'Data Analytics, when used to obtain audit evidence in a financial statement audit, is the science and art of discovering and analyzing patterns, deviations and inconsistencies, and extracting other useful information in the data underlying or related to the subject matter of an audit through analysis, modeling and visualization for the purpose of planning or performing the audit.'
55. A total of 51 respondents provided comments to the request for input (Appendix 4 sets out a list of the respondents). Of those 51 respondents, only four National Auditing Standards Setters (AASB-CNAC, CNCC-CSOEC, JICPA and NBA) and two Member Bodies (AE and CPA Canada) responded that a specific definition of Data Analytics should be included in the ISAs and the JICPA recommended specifically that this definition appear in ISA 500.¹¹
56. Describing how Data Analytics can be used in ISA 315 (Revised) demonstrates the IAASB's response to stakeholder expectations in this area, and could be introduced in other ISA updates in due course. The majority of the DAWG is of the view that IAASB should incorporate the use of Data Analytics in ISA 315 (Revised) as depicted in paragraph 1 above and provides the following options for defining and using the term Data Analytics in ISA 315 (Revised).
 - *Continue to use the existing CAAT term.* The term 'Data Analytics' is not currently used or defined in the ISAs. The closest related term used (although infrequently) in the ISAs is 'computer assisted audit techniques' (CAATs).¹²Continuing to use the existing CAAT term would avoid introducing new terminology and reflects that data analytics, as currently employed, may be seen as the evolution of automated techniques. However, it does not reflect the much broader scope and capability of current and likely future data analytics used by practitioners. The term and use of CAATs may also be outdated and the TF is looking to modernize ISA 315 (Revised) to address the growing need for guidance in the use of technology in the audit of an entity. As such the DAWG through their discussion and deliberation concluded that an approach of continuing to use the term CAATs in ISA 315 (Revised) is not desirable.

¹⁰ Request for Input, [Exploring the Growing Use of Technology in the Audit, with a Focus on Data Analytics](#)

¹¹ ISA 500, *Audit Evidence*

¹² ISA 330, *The Auditors Response to Assessed Risk*, par A16, A27 and defined in the Glossary of Terms

- *Use and define the term “Data Analytics”.* The term Data Analytics is in common use, including in IAASB’s work through the DAWG and its outreach. However, the introduction in ISA 315 (Revised) would be relatively limited and potentially conforming amendments may be needed to other ISAs, such as ISA 330 or ISA 500. The term Data Analytics will also have to be defined for the use in other ISAs. Any definition of Data Analytics may have broad impact on other ISAs and potential consequences simply have not been completely considered by the IAASB at this point. It is likely that any definition of Data Analytics would form a significant portion of the work on substantive revisions to ISA 330 or ISA 500 and thus should be the subject of a separate distinct IAASB task force to deliberate these matters fully and should not viewed as conforming or consequential amendments to other ISAs resulting from amendments to ISA 315 (Revised). As such the DAWG does not recommend using and defining Data Analytics in ISA 315 (Revised).
- *Use a term such as “automated techniques”.* This includes and broadens the existing CAATs terminology and is a versatile and inclusive term without adopting the specific Data Analytics label, which may carry particular expectations or unintended consequences. To meet stakeholder expectations, the Explanatory Memorandum accompanying an Exposure Draft of ISA 315 (Revised) could specifically identify the application material (paragraph 1 above) where the use of Data Analytic techniques as risk assessment procedures are described but referred to as “automated techniques.” This option for incorporating Data Analytic techniques in ISA 315 (Revised) is the preferred option of the DAWG.

Matter for IAASB Consideration

9. The Board is asked for its views on:
- (a) The application material set out in the paragraphs specified in paragraph 51 above in relation to the use of automated tools and techniques (i.e., data analytics) in the performance of risk identification and assessment procedures.
 - (b) The use of ‘automated tools and techniques’ in the application material to ISA 315 (Revised).

Appendices

57. New appendices have been developed or updated as explained in this paper:
- Appendix 1 (NEW)—*Considerations for understanding the Entity and Its Business Model.* Matters previously located in the application material have been relocated consistent with its proposals at the December 2017 meeting where the Task Force expressed the view that these matters are not critical to the auditor’s understanding, but are still helpful.
 - Appendix 2—*Events and Conditions That May Indicate Risks of Material Misstatement.* Existing material in Appendix 2 has been enhanced to categorize the events and conditions by the inherent risk factors.
 - Appendix 3—*Understanding the Entity’s System of Internal Control.* Existing material in extant Appendix 1 has been relocated, updated and enhanced as appropriate to reflect Task Force discussions about changes that may be needed, as well as changes to reflect updates made to COSO Framework 2013. A section within the extant application material relating to ‘limitations of internal control’ has also been relocated as in the Task Force’s view this is not critical understanding but is still helpful context.

Matter for IAASB Consideration

10. The Board is asked for its views on:
- (a) The Appendices as amended; and **Appendix 3 paragraph 6 may be easier to understand if an example is given of a management review control that would qualify as a monitoring control. It may also be appropriate to move this to application guidance, perhaps as part of paragraph A89j.**
 - (b) Whether there are other matters that should be considered to be included in the Appendices to ISA 315 (Revised).

[General observation – some ASB TF members felt the length of some paragraphs wasn't consistent with the clarity drafting conventions, which generally call for more use of bullets and lists in place of long, dense paragraphs.](#)

Draft overview of requirements (referenced in ASB TF's comments on question 4 above):

In every audit, the auditor shall:

1. Obtain an understanding of the following, to provide a basis for initial identification of risks of material misstatement at the overall financial statement and assertion level:
 - a. The entity and its environment (paragraph 11(a))
 - b. The applicable financial reporting framework (paragraph 11(b))
 - c. The following components of the entity's system of internal control:
 - i. The control environment (paragraphs 14 through 14B)
 - ii. The entity's risk assessment process (paragraphs 15 through 17)
 - iii. The entity's process to monitor the system of internal control (paragraphs 17A through 17D)
 - iv. The information system and communication process relevant to financial reporting (paragraphs 18 through 19)
2. Identify risks at the overall financial statement level that are reasonably possible to result in material misstatements (paragraph 1A)
3. Identify classes of transactions, account balances and disclosures containing assertions with inherent risks that are reasonably possible to result in material misstatements (paragraphs 1B through 1D). These classes of transactions, account balances and disclosures are referred to as *significant classes of transactions, account balances and disclosures* (paragraph 4da), and these assertions are referred to as *relevant assertions* (paragraph 4cc)
4. Identify control activities related to these *significant classes of transactions, account balances and disclosures* that are intended to provide reasonable assurance of preventing or detecting material misstatements related to the *relevant assertions* in #3 (paragraph 20(e))
5. Identify other control activities *relevant to the audit* (paragraphs 20(a) through 20(d), 21 and 21A)
6. Evaluate the design of these control activities *relevant to the audit* (#4 and 5), and whether they have been placed in operation (paragraph 21B)
7. Assess the overall financial statement level risks identified in #2

8. For *significant classes of transactions, account balances and disclosures*, assess the following for *relevant assertions*:
 - a. Inherent risk (paragraphs 26 and 27)
 - b. Control risk (paragraph 30A)
9. Design and perform further audit procedures responsive to the risks assessed in #7 and 8

Appendix 1

Task Force Activities Including Outreach and Coordination with Other IAASB Task Forces and Working Groups

1. The following sets out the activities of the Task Force including outreach with others and coordination with other IAASB Task Forces and Working Groups relating to the ISA 315 (Revised) project since December 2017. Further information about the project, including the members of the Task Force, can be found [here](#).

Task Force Activities since the December 2017 IAASB Discussion

2. The ISA 315 Task Force has met once in person, held one teleconference and one video conference since the last IAASB discussion in December 2017.

Outreach with Audit Inspection Bodies

3. Representatives from the ISA 315 Task Force, including the Chair, held a teleconference with representatives of the International Forum of Independent Audit Regulators' (IFIAR) Standards Coordination Working Group (SCWG) (including the Chair) to discuss the progress of the project and to address questions from representatives from IFIAR's SCWG.

Coordination with Other IAASB Task Forces and Working Groups

4. Representatives from the ISA 315 Task Force, including the Chair, held a teleconference with representatives of the DAWG to discuss the integration of the use of automated tools and techniques into the revisions of the application material of ISA 315 (Revised), and in particular, the use of technology as a means to perform risk assessment procedures.
5. The Chair of the Task Force and Staff held a teleconference with the Chairs of the ISA 540 Task Force and Staff to discuss matters that crossover both projects, in particular with regard to the consistency in approach and terms that are used in light of changes that are being made to both standards (see paragraph 5 of this paper).

Extracts from Draft Minutes¹³

ISA 315 (Revised) – December 2018

Ms. Campbell provided an overview of proposed changes to the requirements and application material of ISA 315 (Revised)¹⁴ as presented in **Agenda Items 3-A and 3-B**.

Recognizing that some aspects of the revisions to ISA 315 (Revised) were still being explored by the ISA 315 Task Force, the IAASB broadly supported the direction of the proposals. However, in continuing to explore the different concepts in ISA 315 (Revised), in particular as the application material was progressed, the Board cautioned about the complexity of the explanations provided in the standard to clarify the concepts and flow of ISA 315 (Revised). In addition, the Board asked for further consideration by the ISA 315 Task Force on specific broader matters, including:

- Whether the introduction of the concept '*sufficient and appropriate*' as proposed in paragraphs 5 and 25 is in context of how it is used throughout the ISAs. It was noted that the terms "sufficient and appropriate" is ordinarily associated with audit evidence and if this concept were to be introduced as proposed, this may have unintended consequences.
- Scalability of the standard. The Board agreed that scalability should be presented through the requirements and application material in context of the auditor's consideration of risk (for example based on complexity, not only size, which may impact small and large entities) thereby eliminating the need for "considerations specific to smaller entities." In addition, the Task Force was encouraged to further consider how contrasting examples could be used to reflect scalability when implementing the requirements.
- The development of explanatory material to practically demonstrate the application or "bringing together" of the standard, such as through implementation guidance or flow charts.
- Consistency in the use of terms throughout the changes, for example 'events and conditions' and 'significant disclosures.'
- Whether some introductory paragraphs would be helpful to assist with the linkage to other foundational standards, such as ISA 200, or consequential standards such as ISA 330. It was noted that some paragraphs that had been introduced were more relevant to ISA 200 or ISA 330, and that by relocating these to an introduction may assist with context for the requirements of the ISA 315 (Revised).
- How professional skepticism has been encompassed in the changes.
- Matters relevant to the public sector, in particular the impact of some of the changes on audits being conducted on public sector entities, such as how controls are applied and in some of the terms used, such as business model.

¹³ The draft minutes are still subject to IAASB review and therefore may still change.

¹⁴ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

DEFINITIONS

In relation to the changes proposed changes to the definitions, the Board continued to support:

- Developing a definition for ‘controls.’ However, concern was expressed with the meaning and scope of ‘*informal expectations*’ as proposed in the revised definition.
- Developing a definition for ‘relevant assertions,’ but noted that further clarification was needed to explain the threshold of ‘*reasonable possibility*.’ In addition, the Task Force was asked to further consider how this definition is articulated in comparison to the definition used by the US Public Company Accountancy Oversight Board (PCAOB).
- The definition of qualitative inherent risk factors (QIRFs). However, the Board encouraged further consideration about:
 - The inclusion of the susceptibility to fraud as a qualitative inherent risk factor in light of the QIRF’s being used to identify inherent risk, and fraud being relevant to both inherent risk and control risk. The Board also questioned how this would link to the fraud risk factors in ISA 240.¹⁵
 - How the QIRF’s interact with one another.
 - Whether quantitative considerations should be included.

RISK ASSESSMENT PROCEDURES

There was support for the proposed revisions relating to the risk assessment procedures, but the Board asked that further consideration be given to:

- The scope of risk assessment procedures in paragraph 6 of ISA 315 (Revised), as it appears to be focused or restricted to internal sources only.
- Whether further changes were needed for the auditor to evaluate whether information obtained through prior experience remains relevant and reliable.

UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT

The Board were generally supportive about the proposed changes, but asked that further consideration be given to:

- Further clarifying what is meant by business risks and business model.
- How the QIRF’s are used when obtaining an understanding of the entity and its environment, and the applicable financial reporting framework.

OBTAINING AN UNDERSTANDING OF INTERNAL CONTROL

There was support for the proposals relating to the understanding of the entity’s system of internal control, but the Board asked that further consideration be given to:

- Whether the scope of the required understanding, being ‘*relevant to financial reporting*,’ is not too broad, as this may include irrelevant activities such as how financial statements are published or made available to external stakeholders.

¹⁵ ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

- The work effort required when obtaining an understanding of the control environment, in particular for small and medium sized (SME) entities who may have limited controls in many cases.
- The proposed revisions to the requirement to obtain an understanding of the entity's risk assessment process (paragraph 15 of ISA 315 (Revised)), as it may be too complex and may not be clear about what needs to be done in the absence of such a process.
- The consequences if an entity does not have an appropriate process to monitor its system of internal control (paragraph 17 of ISA 315 Revised) or an effective information system (paragraph 18 of ISA 315 Revised). It was noted that in contrast, when considering paragraphs 15 and 16 of ISA 315 (Revised), the auditor is required to consider whether the absence of an appropriate risk assessment process represents a significant deficiency in internal control.
- Modernizing paragraph 18 about the requirement to obtain an understanding of the information system, in light of how this is done in the current environment. In addition, the ISA 315 Task Force was asked to clarify what was required for each aspect as there seemed to be overlap in the detailed requirements.
- The required understanding of '*control activities*' (paragraph 19A of ISA 315 Revised) and the interaction or relationship of this understanding with '*controls relevant to the audit*' (paragraph 20 of ISA 315 Revised). In addition, the ISA 315 Task Force was asked to explain in the application material how the evaluation of the design of controls, and determination of the implementation, has been undertaken, and to make it clear in what circumstances this was required.

IDENTIFICATION AND ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

Although the Board was supportive that control risk cannot be reduced if the operating effectiveness of controls has not been tested, the ISA 315 Task Force was encouraged to make this clearer in the standard. In addition, the ISA 315 Task Force was asked to further consider:

- Clarifying and explaining how some of the new concepts introduced manifested in the identification and assessment of the risks of material misstatement.
- The documentation requirements when considering factors such as magnitude and likelihood of misstatements, and the QIRFs. In particular, it was not clear how the documentation requirements of ISA 315 (Revised) and the new concepts introduced interact with ISA 230.¹⁶
- Further explaining in the application material how the understanding obtained about the entity's system of internal control, including any work done to evaluate the design and determine the implementation of controls, impacted the auditor's assessment of control risk.
- The concept of '*spectrum of inherent risk*'. The Board continued to be supportive of using this concept but thought that the spectrum of inherent risk could be better emphasized and explained earlier in the standard.
- The consequences or auditor's response if the auditor identifies a risk of material misstatement, and in the auditor's judgment, it is not possible to obtain sufficient appropriate audit evidence only from substantive procedures.

¹⁶ ISA 230, *Audit Documentation*

IAASB CAG CHAIR'S REMARKS

Mr. Dalkin noted continuing support for the direction of the changes being developed, noting that the CAG had been generally supportive of the inclusion of the susceptibility to fraud as a QIRF.

PIOB REMARKS

Ms. Stothers continued to support the direction of the changes, specifically acknowledging the changes being considered to address scalability, and the introduction of the concept of the spectrum of risk and the clarification about the auditor's work in relation to the entity's system of internal control. She also noted support for the inclusion of the susceptibility to fraud as a QIRF, and was encouraged by the work being done to align the QIRFs in ISA 315 (Revised) with the concept in ISA 540 (Revised).¹⁷ Ms. Stothers also encouraged the Task Force to continue to consider how professional skepticism could be encompassed within the standard, particularly as the auditor is obtaining an understanding.

WAY FORWARD

The Task Force will present a second read of the Exposure Draft of proposed changes to ISA 315 (Revised) for IAASB discussion in March 2018.

¹⁷ ISA 540 (Revised), *Auditing Accounting Estimates Including Related Disclosures*

Extracts from relevant Standards

ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with International Standards on Auditing

Audit Risk

- A34. Audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.
- A35. For purposes of the ISAs, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant. Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

Risks of Material Misstatement

- A36. The risks of material misstatement may exist at two levels:
- The overall financial statement level; and
 - The assertion level for classes of transactions, account balances, and disclosures.
- A37. Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- A38. Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk. Auditors use various approaches to accomplish the objective of assessing the risks of material misstatement. For example, the auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an acceptable level of detection risk. Some auditors find such a model to be useful when planning audit procedures.
- A39. The risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements.
- A40. Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations or for accounts consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty. External circumstances giving

rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.

A41. Control risk is a function of the effectiveness of the design, implementation and maintenance of internal control by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation of the entity's financial statements. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of internal control. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. The ISAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures to be performed.¹⁸

A42. The ISAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement." However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

A43. ISA 315 (Revised) establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.

ISA 330 The Auditor's Responses to Assessed Risks

Paragraph 6:

The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level. (Ref: Para. A4–A8)

Paragraph 7:

In designing the further audit procedures to be performed, the auditor shall:

- (a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:

¹⁸ ISA 330, *The Auditor's Responses to Assessed Risks*, paragraphs 7–17

- (i) The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (that is, the inherent risk); and
 - (ii) Whether the risk assessment takes account of relevant controls (that is, the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and (Ref: Para. A9–A18)
- (b) Obtain more persuasive audit evidence the higher the auditor’s assessment of risk. (Ref: Para. A19)

Respondents to Data Analytics Request for Input

Members of the monitoring group are marked with an asterisk (*).

Investors and Analysts

1. Chartered Financial Analyst (CFA) Institute
2. Swiss Expert Association for Audit, Tax and Fiduciary (EXPERT Suisse)
3. Harvest Investments Limited (HIL)

Regulators and Oversight Authorities

4. International Association of Insurance Supervisors (IAIS)*
5. International Forum of Independent Audit Regulators (IFIAR)*
6. Independent Regulatory Board for Auditors (South Africa) (IRBA)
7. United Kingdom Financial Reporting Council (FRC UK)
8. Haut Conseil du Commissariat aux Comptes (H3C)

National Auditing Standard Setters

9. Australian Auditing and Assurance Standards Board (AUASB)
10. Canadian Auditing and Assurance Standards Board (CAASB)
11. Compagnie Nationale des Commissaires aux Comptes and the Conseil Supérieur de l'Ordre des Experts-Comptables (CNCC-CSOEC)
12. Institut der Wirtschaftsprüfer (IDW)
13. National Association of State Boards of Accountancy's (NASBA)
14. The Japanese Institute of Certified Public Accountants (JICPA)
15. Malaysian Institute of Certified Public Accountants (MICPA)
16. Nederlandse Beroepsorganisatie van Accountants (NBA)
17. New Zealand Auditing and Assurance Standards Board (NZAuASB)

Accounting Firms

18. BDO International Limited (BDO)
19. Baker Tilly UK Audit LLP (BT)
20. Crowe Horwath International (CHI)
21. Deloitte Touche Tohmatsu Limited (DTT)
22. Ernst & Young Global Limited (EYG)
23. RSM International (RSM)
24. KPMG IFRG Limited (Network) (KPMG)
25. Moore Stephens LLP (United Kingdom firm) (MS)
26. PKF International Limited (PKF)

27. PricewaterhouseCoopers International Limited (PwC)

Public Sector Organizations

28. Auditor General of Alberta (AGA)
29. Auditor General of New Zealand (AGNZ)
30. The Chartered Institute of Public Finance and Accountancy (CIPFA)

Member Bodies and Other Professional Organizations

31. Accountancy Europe (AE)
32. Association of Chartered Certified Accountants (ACCA)
33. American Institute of Certified Public Accountants (AICPA)
34. Chartered Accountants Australia and New Zealand (CAANZ)
35. Chartered Professional Accountants of Canada (CPA Canada)
36. Certified Practising Accountant Australia (CPA Australia)
37. European Federation of Accountants and Auditors for SMEs (EFAA)
38. Institute of Chartered Accountants in England and Wales (ICAEW)
39. Institute of Chartered Accountants of Scotland (ICAS)
40. Institute of Singapore Chartered Accountants (ISCA)
41. Malaysian Institute of Accountants (MIA)
42. Pennsylvania Institute of Certified Public Accountants (PICPA)
43. South African Institute of Chartered Accountants (SAICA)
44. IFAC Small and Medium Practices Committee (SMPC)

Academics

45. Hunter College Graduate Program, Economics Department (Prof. Joseph A. Maffia) (HC)
46. Rutgers, The State University of New Jersey (Accounting and Information Systems Department) (RU)

Individuals and Others

47. Denise Silva Ferreira Juvenal
48. Inflo Limited
49. Shigeto Fukuda
50. Tom Koning
51. Institute of Management Accountants (IMA)