



Agenda Item 8

ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatements*

Objective of Agenda Item

To discuss overall issues arising from the comment letters received by the International Auditing and Assurance Standards Board (IAASB).

Task Force

The Task Force members are as follows:

- Tracy Harding–BerryDunn, Chair
- Pat Bottomly–BDO
- Dora Burzenski (supported by Sally Ann Bailey)–Deloitte
- Diane Hardesty–EY
- Kathy Healy–PwC
- Susan Jones–KPMG
- Maria Manasses–GT
- Dan Wernke–Clark Schaefer Hackett

Background

In July 2018, the IAASB issued an Exposure Draft that included a proposal to revise ISA 315, *Identifying and Assessing the Risks of Material Misstatements*, (ISA 315). The comment period ended November 2, 2018. At its March 2019 meeting, the IAASB discussed overall issues arising from the comment letters. More specifically, the following were the key themes discussed by the IAASB:

- a. the ISA 315 Task Force’s initial proposals to address specific responses to the proposed ISA 315, in particular, the broad concerns in relation to the length and complexity of the standard, and
- b. proposed changes to address specific issues within the section on understanding the entity’s system of internal control.

In February 2019, the ASB Task Force met to discuss the IAASB agenda papers in preparation for the February International Auditing Standards Task Force meeting. Below is a table which summarizes the ASB Task Force views on the questions in the issues paper presented to the IAASB.

<i>Question</i>	<i>ASB Task Force Comment</i>
<p>1. Board members are asked for views about the broad approach to apply an overall response to draft the requirements in a different way as set out in Column 4 of Agenda Item 4-A (and as explained in paragraphs 19–33 above). In particular, members are asked to comment on whether such an approach could be an effective way to address the overarching comments from respondents relating to complexity and scalability/proportionality, and if not, why not?</p>	<ul style="list-style-type: none"> • Most ASB TF members preferred the ED approach. • The ASB task force members expressed mixed views on option 1 vs. option 2. <ul style="list-style-type: none"> ○ Option 1 proponents are concerned the specific areas to understand will be forgotten once they are moved to the definition, at least on an ongoing basis. ○ Option 2 fans think option 1 changes the words from the ED too much, and like the streamlining of the requirement, which can then be fleshed out in application material or other guidance for different levels of client complexity. Mixed views on ordering in option 1 – evaluation first vs. procedures first. • The IAASB expressed similar mixed views; however, it decided to go with option 2. • The ASB task force expressed a concern too, with regard to option 2, about moving further from the COSO definitions from the standpoint of confusing auditors in jurisdictions in which COSO is heavily used, though we understand they are still in the spirit of COSO.
<p>2. The IAASB is asked for its views about the manner in which the overall response developed by the Task Force has been applied in Column 4 (Option 2) of Agenda Item 4-A. In particular, the IAASB is asked:</p> <p>(a) Whether the proposed requirements are presented at the correct level of detail, i.e., is there too little detail or too much detail?</p>	<ul style="list-style-type: none"> • Some ASB task force members continue to believe the individual evaluations are unnecessary and add complexity. • These members suggest limiting the requirement to obtaining the required understanding for the purpose of assessing financial statement-level risk and relate that understanding to the paragraph that contains the requirement to assess risk at the financial statement-level. For example,

<p>(b) Whether there are important missing concepts from the requirements due to their presentation in this manner (both overall as well as for individual aspects)?</p> <p>(c) Whether the use of definitions is appropriate and should be further explored, and if not, where should the detailed aspects related to understanding the individual components of internal control be presented?</p> <p>(d) Whether there are any other matters the Task Force should consider in relation to the requirements presented in Column 4 of Agenda Item 4-A?</p>	<p>the introductory wording to paragraph 39 in option 2 seems to accomplish that well, as a lead-in to the process in paragraphs 45-47.</p> <ul style="list-style-type: none"> • Majority view that discussion of control deficiencies in the individual components should be deleted because it is covered by paragraph 44. The IAASB decided to have one requirement that would address control deficiencies rather than having separate requirements for each of the components of internal control. The Task Force also suggested deleting wording in paragraph 25 about internal control understanding providing a basis for ISA 265 communications as this wording unduly elevates this requirement; as worded, it suggests that identifying control deficiencies is an objective of the audit rather than a byproduct. • Those ASB TF members who support deleting the individual requirements and the discussion of control deficiencies (deferring instead to paragraph 44) believe these changes will have a greater impact on understandability and scalability than moving portions of the requirements to the definition.
<p>3. The IAASB is asked for whether the Task Force should pursue the presentation approach in Column 3 or Column 4 as it makes proposals to revise ED-315, or whether there is an alternative that should be further explored.</p>	<p>See above – majority would opt for ED approach [IAASB opted for option 2].</p>
<p>4. The IAASB is asked for its views about the proposed individual changes, as presented in Column 3 of Agenda Item 4-A (and the Appendix to Agenda item 4-A), in particular:</p>	

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<p>(a) Whether detailing the purpose of the required understanding, as explained in paragraphs 49–54 above, helps with concerns as to why an understanding is needed;</p>	<p>The ASB Task Force suggests that the proposed ISA should clearly make the point that understanding internal control helps identify risks, which then informs decisions regarding the nature, timing and extent of substantive procedures, in addition to the impact on the control risk assessment. For example, understanding where management has deemed controls are necessary can help an auditor understand where management believes there are risks. The point about helping identify control deficiencies should be limited to focusing on how they may affect the design of further audit procedures, rather than listing communication of these as part of the purpose of 315; communication of these is a byproduct of the audit, not a purpose of the audit.</p>
<p>(b) Deleting paragraph 26 in ED-315 to reduce complexity and confusion; and</p>	<p>The ASB Task Force supports this deletion since addressed in paragraph 42.</p>
<p>(c) Proposed changes to terminology as described in paragraphs 55–59 above.</p>	<ul style="list-style-type: none"> • Majority of ASB TF would prefer to keep the term “controls relevant to the audit.” • Some sentiment for deleting “as relevant” from the lead-in in paragraph 39. • Important to add more application material to support paragraph 39(c), as this is often an area of confusion. AICPA Technical Questions and Answers would also be helpful in this regard. • “Control activities” should not be the heading for paragraph 39. Should either delete control activities from the standard or add a new paragraph 38 that makes the point that control activities are contained within the other four components of internal control. Wording in PCAOB standard 2110.34 may be helpful for that purpose. Also suggest application material explaining that transaction controls are a common form of control activities.

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	<ul style="list-style-type: none"> • Recommend the language in paragraph 35 about whether the information supports the preparation of financial statements align with the description of management’s responsibilities in ISA 700 (e.g., mention of fair presentation). • One comment that the phrase “in addition to inquiry” in paragraph 42(b) (which is also in extant) implies that inquiry is always required, and asked if that was the intent; if not, recommend the language be tweaked to clarify.
<p>5. The IAASB is asked for its views about the proposed changes in the individual components of internal control, as presented in Column 3 of Agenda Item 4-A (and the Appendix to Agenda item 4-A), in relation to:</p>	<p>Control deficiencies – paragraph 44 does a good job of covering the implications of these for the risk assessment and response process; as noted above, recommend deleting discussion thereof in individual components, and also deleting paragraph 43 which is already covered by ISA 265.</p>
<p>(a) The control environment as explained in paragraphs 67–69 above</p>	<p>Nothing other than general points regarding questions #1-3 above.</p>
<p>(b) The entity’s risk assessment process and process to monitor the system of internal control as explained in paragraphs 70–71 above;</p>	<ul style="list-style-type: none"> • One TF member expressed the view that the risk assessment definition should explicitly mention fraud risk, rather than just mentioning in application material as in the ED. • One TF member expressed the view that the mention of internal audit should include the reference to its organizational status; this is in option 1, but was removed in option 2. • Otherwise, nothing other than general points regarding questions #1-3 above
<p>(c) The information system and communication component as explained in paragraphs 72–76 above; and</p>	<ul style="list-style-type: none"> • For significant classes of transactions, account balances and disclosures (SCOTABDs), suggest mentioning the auditor needs to understanding both routine processing and the process for making adjustments, including financial statement-level adjustments, to explain why it is important in

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	<p>paragraph 39 to understand controls over “journal entries;” maybe define those as controls over adjustments in SCOTABDs that are not part of routine processing.</p> <ul style="list-style-type: none"> • Paragraph 35 –Moving “whether the information system” to immediately precede “appropriately” would enhance the understandability of the sentence.
<p>(d) The control activities component as explained in paragraphs 77–81</p>	<p>Nothing other than comments regarding question #4(c) above.</p>
<p>6. Are there any other matters relating to understanding the entity’s system of internal control that the Task Force should consider as it progresses the changes to ED-315?</p>	<ul style="list-style-type: none"> • Scalability may be enhanced by focusing application material on how the entity achieves the objectives encompassed in the definition of each component, which may be informal for less complex entities. On the other hand, they may not be adequately addressed for some such entities, which would then inform the design of further audit procedures. Recommend explaining that the term <u>components</u> (which implies both formality and distinctness, when for many private companies they are informal and significantly overlap) is really referring to “aspects” or “objectives” of internal control which likely overlap at times. • Examples of controls that are, and are not, properly designed would be helpful, either in application material or otherwise (e.g., an IAPN). • Paragraph 44(b) – would also apply to control deficiencies at the assertion level. Also recommend deleting the word “overall.” Some discussion about revisiting the intent of this paragraph, and reconsidering wording accordingly. • One recommendation to add application material to paragraph 44 about considering the severity of control deficiencies for the purposes of this paragraph.

<p>7. The IAASB is asked for its views about the proposed changes as described in paragraph 90 above and the provided revised drafting.</p>	<ul style="list-style-type: none"> • The notion that “risk of material misstatement” is based on both inherent and control risk, but “risks of material misstatement” (at the assertion level) are based only on inherent risk, seems unnecessarily confusing, especially when the latter requirement comes after the internal control understanding section. • The first sentence of paragraph A207 seems to indicate <u>all</u> risks of material misstatement are based on, in part, the internal control understanding. Seems like that will need some work, as it could be viewed as contradicting the notion that risks of material misstatement at the assertion level are identified based solely on inherent risk. • Also, paragraph 46 seems oddly placed, coming after the internal control understanding for the information system and control activities components which are based on SCOTABDs. Perhaps could be addressed by moving them. • Also, are we saying risks of material misstatement at the financial statement level are based on inherent and control risk? Seems like the process of identifying them at least considers the understanding of the indirect components of internal control; should clarify. <p>ASB TF recommends not making the change recommended to paragraph 45(b) for these reasons. Minority support for ending the sentence after the word “disclosures.”</p>
<p>8. In addressing the issues raised relating to relevant assertions and SCOTABDs, in particular those that noted complexity:</p>	
<p>(a) Board members are asked for views about the proposed changes made to the definition of relevant assertions in</p>	<p>It is unclear how the views of respondents described above necessitate the significant change of moving the “reasonably</p>

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paragraph 101 and whether further changes are needed to SCOTABDs in paragraph 102.	possible” threshold out of the definition of relevant assertion. We think it’s more understandable there.
(b) What are the IAASB’s views on the Task Force explanations of the relationship of ‘ <i>reasonable possibility</i> ’ to the definition of ‘ <i>risk of material misstatement</i> ’? Does the IAASB agree with the Task Force’s preferred option in paragraph 107, and why, or why not?	The ASB Task Force supports leaving it in the definition of relevant assertion, so that it’s part of the 315 requirements. Some support for removing “more than remote” from the definition, but no consensus; if it needs to be there, recommend keeping both “reasonably possible” and “more than remote.”
	An additional thought – It would be helpful to clarify whether the understanding of the indirect components of internal control, and the information systems component, informs the decision as to whether an assertion is a relevant assertion. In other words, does the likelihood of material misstatement consider the <u>understanding</u> of these components (prior to the identification of paragraph 39 controls and evaluation of their D&I)? Ties into the point under questions #4(a) and 7 (response (d)) above.
9. The IAASB is asked for its views on:	
(a) Changing the definition of significant risk as explained in paragraph 111 above.	The ASB Task Force didn’t discuss, but its chair agrees.
(b) Retaining the description of significant risks as being “close to the upper end of the spectrum of inherent risk” but providing further application material to support a more consistent application.	The ASB Task Force didn’t discuss, but its chair agrees.
10. The IAASB is asked:	
(a) For its views on retaining both the stand-back in paragraph 52 of ED-315, and paragraph 18 of ISA 330, subject to the changes noted, in light of the responses that have been received.	Disagree – delete 330.18. Minority view of the ASB Task Force that ISA 315 standback is also not necessary, under the assumption all material classes of transaction, account balances, and disclosures would be considered SCOTABDs.
(b) Whether it agrees with the removal of ‘qualitative’ and ‘quantitative’ in paragraph 18 of ISA 330.	The ASB Task Force agrees.
(c) For views about the redrafted paragraph 52 of ED-315 as illustrated in paragraph 125 above.	The ASB Task Force agrees.

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11. The IAASB is asked for its views on the matters set out in paragraphs 131–133 above.	The ASB Task Force didn't discuss, but its chair agrees.
12. The IAASB is asked for its views on the matters set out in paragraph 137 above.	The ASB Task Force agrees.
13. The IAASB is asked for its views on how the Task Force proposes to approach changes to the application material to address issues related to scalability and proportionality, and complexity and understandability, as set out in paragraphs 138–143 above. Are there any other suggestions about how this can be done?	See suggested categories for content to be moved to IAPN in ASB comment letter. Minority concern about putting examples in boxes, from the standpoint of readability of application material (especially if examples are lengthy).