



Agenda Item 5

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

Objective of Agenda Item

To discuss preliminary issues identified by the Task Force while monitoring the International Auditing and Assurance Standards Board (IAASB) ISA 315 project.

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.

At its June 2019 meeting, the IAASB discussed issues with respect to the ISA 315 Task Force proposed changes to respond to the comments received in connection with the Exposure Draft. In particular, the ISA 315 Task Force sought IAASB’s views about:

- a. The new approach in presenting the requirements and application material to broadly address complexity, and scalability and proportionality issues raised, and
- b. Specific proposed changes to address comments relative to the definitions, requirements, and application material.

In the following section are descriptions of the preliminary issues identified by the ASB Risk Assessment Task Force (the “Task Force”) based on the June 2019 IAASB meeting.

General

New Drafting Approach

Based on the feedback by the IAASB at its March 2019 meeting, the ISA 315 Task Force has instituted a “new” drafting style or approach to address the overarching concerns in relation to the length and complexity of ED-315, as well as scalability and proportionality. Under this drafting approach, the requirements would be streamlined to focus on the “what” aspect of the requirements; the “why” and “how” aspects would be relocated to the application material. In addition, certain explanatory material embedded within requirements would be relocated to the relevant definitions in the definitions section of the standard.

At the June 2019 meeting, the IAASB was supportive of the approach to relocate the “why” and “how,” but decided against relocating the explanatory material from the requirements and thus decided to reconnect the definitions and the requirements (see attached Agenda Item 2F [Updated] illustrates the revised drafting approach).

Consideration of PCAOB standards

A Task Force member believes that the ASB also should consider the extent to which the revised AU-C 315 would align with the PCAOB standards. A concern is creating significant differences in risk assessment (for example, whether the proposed standard would come to different conclusions as to what is a significant account or disclosure or what is a significant risk). It is thus important to determine whether the revised AU-C 315 would be able to bridge the language differences such that different conclusions would not be reached.

Material Account Balances and Disclosures

An issue is whether to retain this notion and align it with the ISA or to eliminate this construct and align it with PCAOB. A revised AU-C 315 needs to be very clear that size does not necessarily equal materiality. With all of the changes made to the standards, the requirement may be interpreted as if materiality is applied at the general ledger account level and not the financial statement line item level. A significant concern is that the IAASB is not appropriately addressing this point.

Audit Evidence

The proposed ISA 315 contains several references to the concepts of audit evidence (for example, see paragraphs 17 and 19 in agenda Item 2A). The Task Force recommends that the ASB Audit Evidence Task Force review references to “audit evidence” contained herein for any implications for consistency with that project.

Definitions

The following table summarizes the Task Force’s comments on the proposed definitions.

[Note: paragraphs in grey represent paragraphs revised by the IAASB in June 2019 following the initial discussions of the proposed ISA 315.]

<i>Definition</i>	<i>Task Force Comment</i>
Inherent Risk Factors – Characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors in so far as they affect inherent risk.	Members raised the issue whether the inherent risk factors can relate to financial statement level risk (definition is focused on assertion level risk).
<p><i>Significant risk</i> – An identified risk of material misstatement:</p> <ul style="list-style-type: none"> (i) For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which the inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of potential misstatement should that misstatement occur; or (ii) That is to be treated as a significant risk in accordance with the requirements of other ISAs.¹ (Ref: Para. A10) 	The Task Force expressed a concern that as drafted, this definition may create a change in practice. It is not clear in the definition that both likelihood and magnitude need to be close to the upper end of the spectrum, that is, a dimension could be at a lower stratum. The definition in extant AU-C 315 has been interpreted to be “the highest of the high.” Also, a concern was expressed about whether this definition would create a difference with the PCAOB definition.

Questions for the ASB

¹ ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 27 and ISA 550, *Related Parties*, paragraph 18

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1. What are the ASB's views with respect to the proposed definitions and comments summarized above?

Requirements

The following table summarizes the Task Force's comments on the requirements of the proposed ISA 315.

[Note: paragraphs in grey represent paragraphs revised by the IAASB in June 2019 following the initial discussions of the proposed ISA 315.]

<i>Paragraph No.</i>	<i>Task Force Comment</i>				
<p>18. The risk assessment procedures shall include the following: (Ref: Para AXX–AXX)</p> <p>(a) Inquiries of management, <u>and</u> of <u>other</u> appropriate individuals within the <u>entity internal audit function</u> (if the function exists), and of others within the entity who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. (Ref: Para. AX–AX)</p> <p>(b) Analytical procedures. (Ref: Para. AX–AX)</p>	<p>The Task Force expressed some concern about deleting explicit requirement to make inquiry of internal audit, although we recognize the principle is explained in the application material in a manner that includes consideration of internal audit, if applicable.</p>				
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td colspan="2"> <p>30. The auditor shall perform risk assessment procedures to obtain an understanding of the entity's risk assessment process through (Ref: Para. A117–A120 and Para. A123–A128a; Para. A131–A135a)</p> </td> </tr> <tr> <td style="width: 50%; vertical-align: top;"> <p>(a) Understanding the entity's process for:</p> <p>(i) Identifying business risks relevant to financial reporting objectives;</p> <p>(ii) Assessing the significance</p> </td> <td style="width: 50%; vertical-align: top;"> <p>(b) Evaluating whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature</p> </td> </tr> </table>	<p>30. The auditor shall perform risk assessment procedures to obtain an understanding of the entity's risk assessment process through (Ref: Para. A117–A120 and Para. A123–A128a; Para. A131–A135a)</p>		<p>(a) Understanding the entity's process for:</p> <p>(i) Identifying business risks relevant to financial reporting objectives;</p> <p>(ii) Assessing the significance</p>	<p>(b) Evaluating whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature</p>	<p>The Task Force has expressed continued concern about need to "evaluate" each component of internal control; in particular, the requirement in paragraph 35A to evaluate whether the relevant aspects of the information system and communication appropriately support the preparation of financial statements seems to go beyond the objective of risk assessment procedures, and approach that of an internal control exam. In sub-paragraph b) and corresponding paragraphs for the other components, a suggestion is to change <i>evaluating</i> to <i>considering</i>.</p> <p>The Task Force supports combining the step related to the risk assessment and monitoring components.</p>
<p>30. The auditor shall perform risk assessment procedures to obtain an understanding of the entity's risk assessment process through (Ref: Para. A117–A120 and Para. A123–A128a; Para. A131–A135a)</p>					
<p>(a) Understanding the entity's process for:</p> <p>(i) Identifying business risks relevant to financial reporting objectives;</p> <p>(ii) Assessing the significance</p>	<p>(b) Evaluating whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature</p>				

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<i>Paragraph No.</i>	<i>Task Force Comment</i>
<p>of those risks, including the likelihood of their occurrence; and</p> <p>(iii) Addressing those risks.</p> <p>and size of the entity.</p>	<p>However, the Task Force noted that fraud risks in the risk assessment process application material is not mentioned. A Task Force member believes that ISA 240 does address the entity’s risk assessment process in regard to fraud. However, the importance of fraud risks to the evaluation is not as clear as what is included in extant ISA 315.</p> <p>In addition, separate evaluations are not performed just because ISA 240 and 315 are separate standards. So, either limit the bullet in 315 to business risks and add an equivalent requirement to ISA 240 in regard to fraud risk or make clear that this evaluation also includes fraud risks.</p> <p>This requirement would seem to apply to both fraud and error. It is also important to note that AU-C 940 more clearly highlights the consideration of fraud because it aligns with the COSO principles.</p> <p>The following is a suggested edit, using the “principles” in AU-C 940:</p> <p style="padding-left: 40px;">Evaluating whether the entity’s risk assessment process relevant to achieving the entity’s financial reporting objectives, including the potential for fraud, is appropriate to the entity’s circumstances considering the nature and size of the entity.</p> <p>(A footnote can be added to ISA 240 with regard to the reference to fraud.)</p>

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<p>31. If the auditor identifies risks of material misstatement that management failed to identify, the auditor shall obtain an understanding of why the entity’s risk assessment process failed to identify such risks of material misstatement.</p>	<p>The work effort in paragraph 31 seems greater than the extant requirement (which factors in whether the auditor expects management’s process would have identified the risk), which we do not believe is the intent.</p> <p>The Task Force expressed a concern that the audit documentation required under this paragraph is not clear. A suggestion would be to include this requirement in paragraph 30b.</p>		
<p>31A. The auditor shall perform risk assessment procedures to obtain an understanding of the entity’s process for monitoring the system of internal control through:</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; vertical-align: top;"> <p>(a) Understanding those aspects of the entity’s process that address:</p> <p style="margin-left: 20px;">(i) Ongoing and separate evaluations for monitoring the effectiveness of controls, and the identification and remediation of control deficiencies identified; and</p> <p style="margin-left: 20px;">(ii) The entity’s internal audit function, if any, including its nature, responsibilities and activities.</p> </td> <td style="width: 50%; vertical-align: top;"> <p>(b) Evaluating whether the entity’s process for monitoring the system of internal control is appropriate to the entity’s circumstances considering the nature and size of the entity.</p> </td> </tr> </table>	<p>(a) Understanding those aspects of the entity’s process that address:</p> <p style="margin-left: 20px;">(i) Ongoing and separate evaluations for monitoring the effectiveness of controls, and the identification and remediation of control deficiencies identified; and</p> <p style="margin-left: 20px;">(ii) The entity’s internal audit function, if any, including its nature, responsibilities and activities.</p>	<p>(b) Evaluating whether the entity’s process for monitoring the system of internal control is appropriate to the entity’s circumstances considering the nature and size of the entity.</p>	<p>In sub-paragraph b), a suggestion is to change <i>evaluating</i> to <i>considering</i>.</p>
<p>(a) Understanding those aspects of the entity’s process that address:</p> <p style="margin-left: 20px;">(i) Ongoing and separate evaluations for monitoring the effectiveness of controls, and the identification and remediation of control deficiencies identified; and</p> <p style="margin-left: 20px;">(ii) The entity’s internal audit function, if any, including its nature, responsibilities and activities.</p>	<p>(b) Evaluating whether the entity’s process for monitoring the system of internal control is appropriate to the entity’s circumstances considering the nature and size of the entity.</p>		

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<p>33. The auditor shall obtain an understanding of the sources of the information used in the entity’s process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose.</p>	<p>The Task Force noted that this paragraph seems to be out of order; a suggestion would be to attach it as bullets to paragraph 30 to be more consistent with the format of paragraph 28.</p>		
<p>36. The auditor shall perform risk assessment procedures to obtain an understanding of the entity’s information system and communication through (Ref: Para. A135i–A159)</p> <table border="0" style="width: 100%;"> <tr> <td style="width: 50%; vertical-align: top;"> <p>(a) Understanding the entity’s information processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances and disclosures:</p> <p>(i) How information flows through the entity’s information system, including how:</p> <p>a. Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, and incorporated in the general ledger and reported in the financial statements; and</p> <p>b. Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial statements.</p> </td> <td style="width: 50%; vertical-align: top;"> <p>(c) Evaluating whether the relevant aspects of the entity’s information system and communication appropriately supports the preparation of the entity’s financial statements in accordance with the applicable financial reporting framework.</p> </td> </tr> </table>	<p>(a) Understanding the entity’s information processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances and disclosures:</p> <p>(i) How information flows through the entity’s information system, including how:</p> <p>a. Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, and incorporated in the general ledger and reported in the financial statements; and</p> <p>b. Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial statements.</p>	<p>(c) Evaluating whether the relevant aspects of the entity’s information system and communication appropriately supports the preparation of the entity’s financial statements in accordance with the applicable financial reporting framework.</p>	<p>In sub-paragraph c), a suggestion is to change <i>evaluating</i> to <i>considering</i>.</p> <p>Also, the Task Force raised the issue that is not clear whether the understanding required by sub-paragraph (a)iii is limited to significant classes of transactions, account balances, and disclosures.</p>
<p>(a) Understanding the entity’s information processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances and disclosures:</p> <p>(i) How information flows through the entity’s information system, including how:</p> <p>a. Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, and incorporated in the general ledger and reported in the financial statements; and</p> <p>b. Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial statements.</p>	<p>(c) Evaluating whether the relevant aspects of the entity’s information system and communication appropriately supports the preparation of the entity’s financial statements in accordance with the applicable financial reporting framework.</p>		

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<p>(ii) The accounting records, specific accounts in the financial statements and other supporting records relating to the flows of information in the information system;</p> <p>(iii) The financial reporting process used to prepare the entity's financial statements, including disclosures; and</p> <p>(iv) The entity's resources, including the IT environment, relevant to (a)(i) to (a)(iii) above; and</p> <p>(b) Understanding how the entity communicates significant matters that support the preparation of the financial statements and other reporting responsibilities in the information system and other components of the system of internal control:</p> <p>(i) Between people within the entity, including how financial reporting roles and responsibilities are communicated;</p> <p>(ii) Between management and those charged with governance; and</p>	

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<p>(iii) With external parties, such as those with regulatory authorities.</p>		
<p>39. The auditor shall perform risk assessment procedures to obtain an understanding of control activities through: (Ref: Para. A160–A179)</p>		<p>Under subparagraph (a)iii the auditor would identify control activities relevant to the audit using his/her professional judgment. However, it is unclear how would the auditor make this identification. We continue to believe that the ASB’s Q&As would be helpful in this regard, either as application material or other guidance issued concurrently with, or soon after, revised ISA 315.</p> <p>Subparagraph (a)iii suggests that whether a control activity is relevant to the audit is dependent on the assessment of risks of material misstatement, that is where they “fall on the spectrum of inherent risk.” The Task Force believes that this should be moderated to “based on inherent risks identified.”</p> <p>In subparagraph (d)ii, the phrase “in addition to inquiry” is not clear as to whether it is intended to be at the control level or is intended to be at a broader, collective level. As phrased, it suggests that inquiry is always required for every control. A suggestion would be to say: “Inquiry alone is not sufficient.”</p> <p>Also, the Task Force noted that the following sentence from paragraph 21 of extant AU-C 315 is not captured in this requirement:</p> <p style="padding-left: 40px;">An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them. However, the auditor should obtain an understanding</p>
<p>(a) Identifying controls that address risks of material misstatement at the assertion level in the control activities component, as follows:</p> <p>(i) Controls that address risks that are identified as a significant risk;</p> <p>(ii) Controls over journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments;</p> <p>(iii) Controls that are necessary for the auditor to identify to achieve the objectives in paragraph 17(a) and (b) because of where the assessments of the related risks of material misstatement at the assertion level fall on the spectrum of inherent risk; and</p> <p>(iv) Controls for which the auditor plans to test operating</p>	<p>(d) For each control identified in (a) or (c)(ii):</p> <p>(i) Evaluating whether the control is designed effectively to address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls; and</p> <p>(ii) Determining whether the control has been implemented by performing procedures in addition to inquiry of the entity’s personnel. (<i>previously para. 41</i>)</p>	

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<p>effectiveness in determining the nature, timing and extent of substantive testing, which shall include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.</p> <p>(b) Based on controls identified in (a), identifying the IT applications and the other aspects of the entity’s IT environment that are subject to risks arising from the use of IT. <i>(previously part para. 40)</i></p> <p>(c) For such IT applications and other aspects of the IT environment identified in (b), identifying:</p> <p>(i) The related risks arising from the use of IT; and</p> <p>(ii) The entity’s general IT controls that address such risks. <i>(previously part para. 40)</i></p>	<p style="text-align: center;">of the process of reconciling detailed records to the general ledger for material account balances.</p> <p>We recommend this requirement be retained, with “material” replaced by “significant.”</p>
<p>(a)</p> <p>42. For each control identified in the <u>control activities component</u> the auditor shall:</p> <p>(a) Evaluate whether the control is designed effectively to <u>address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls</u>; and</p>	<p>The Task Force recommends saying “For each control identified in paragraph 39.” Other control activities may happen to be identified that do not meet the criteria of paragraph 39; the requirements of paragraph 42 should not apply to these activities.</p>

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<p>(b) Determine whether the control has been implemented <u>by performing procedures in addition to inquiry of the entity's personnel.</u></p>	<p>Also, subparagraph (a) should say "...or effectively designed to support the operation of other <u>such</u> controls".</p> <p>Design and implementation is limited to the control activities component. We discussed (but did not come to a conclusion regarding) whether controls may exist in other components that may be relevant to the audit and thus subject to design and implementation, and recommend this question be considered before finalizing this wording.</p>
<p>43. <u>Based on the auditor's evaluation of each of the components of the entity's system of internal control, the auditor shall determine whether one or more control deficiencies have been identified.:</u></p> <p>(a) — Whether one or more control deficiencies within the system of internal control have been identified; and</p> <p>(b) If so, whether the control deficiencies, individually or in combination, constitute significant control deficiencies.</p>	<p>Paragraph 43 – as noted above, some members of the task force continue to be troubled by broad references to “the auditor’s evaluation of each of the components of internal control”, as it sounds like it is approaching an audit of ICFR; recommend instead saying “Based on the procedures performed in paragraphs 28-39”, which contain more specific evaluation requirements than “evaluation of each of the components”.</p> <p>A Task Force member expressed a concern that the evaluation takes control deficiencies into account. So, it is not clear that the evaluation is based on the deficiencies identified, rather than that the purpose of the evaluation is to identify deficiencies. These are two different things. Also, from an audit perspective, identified deficiencies are accumulated. This wording may imply that an auditor searches for deficiencies in these components, going back to the original comment about how this relates to the evaluation.</p>
<p>45. The auditor shall identify the risks of material misstatement and determine whether they exist at:</p> <p>(a) The financial statement level, or</p> <p>(b) The assertion level for classes of transactions, account balances, and disclosures.</p>	<p>This requirement would require the auditor to assess the risk of material misstatement at the assertion level. Because the proposed ISA 315 introduces the definition of <i>relevant assertion</i>, the requirement should clarify that the assessment of the risk of material misstatement should be performed at the <u>relevant</u> assertion level.</p>

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	<p>A Task Force member raised the issue whether the IAASB is meaning an intentional difference from extant. This seems like an auditor documents risks of material misstatement and then links them to financial statement level or assertion level, rather than just documenting whether they exist at the financial statement level or relate to one or more specific assertion level risks.</p> <p>Extant ISA 315 just says “identify and assess the risks of material misstatement at” – what is really the difference here?</p>
<p><u>510. For identified risks of material misstatement at the assertion level, the auditor shall assess control risk. If the auditor plans to test the operating effectiveness of controls, the auditor shall assess control risk. If the auditor does not intend to test the operating effectiveness of controls, the assessment of the risk of material misstatement is based on inherent risk.</u></p>	<p>The Task Force noted that this requirement indicates you only assess control risk if you intend to assess operating effectiveness, but application material (subparagraph (b) in column 4) tells you to assess control risk (at the maximum) even if you do not test the operating effectiveness of controls.</p> <p>Paragraph A135e does not seem to cover controls over journal entries (paragraph 39(b)); seems like lead-in to the bullets should say “include those.” A135e reads as follows:</p> <p>A135e. The controls that the auditor is required to identify in accordance with paragraph 39 and evaluate the design and determine the implementation of in accordance with paragraph 42 are those:</p> <ul style="list-style-type: none"> • On which the auditor intends to rely on the operating effectiveness of in determining the nature, timing and extent of substantive procedures because the evaluation of such controls provides the basis for the auditor’s design of test of control procedures in accordance with ISA 330. Further, when a control is not designed or implemented effectively, there is no benefit in testing it. Such controls include controls that address risks for

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	<p>which substantive procedures alone cannot provide sufficient appropriate audit evidence.</p> <ul style="list-style-type: none"> • That address risks of material misstatement at the assertion level that have been assessed as higher on the spectrum of inherent risk because ISA 330 requires more persuasive audit evidence the higher the auditor’s assessment of risk². Such controls include controls that address significant risks and controls over journal entries. The auditor’s identification and evaluation of such controls may provide the auditor with a greater understanding of the risks of material misstatement, including the identification of additional risks of material misstatement. This understanding also provides the basis for the auditor’s design of the nature, timing and extent of substantive audit procedures that are responsive to the related assessed risks of material misstatement. <p>A Task Force member noted that this requirement contradicts the AICPA Audit Sampling Guide, which allows some “credit” for design. Will this change, if adopted by the ASB, result in a need to eliminate this from the Audit Sampling Guide? Paragraph 3.26 of the Audit Sampling Guide reads as follows:</p> <p>3.26 When the auditor has performed only an assessment of design and implementation and assessed the design as effective and has obtained evidence that the controls have been implemented, the auditor might use a slightly lower confidence level for detailed substantive procedures (for example, 92 percent or 93 percent rather than a 95 percent confidence level if</p>

² ISA 330, paragraph 7(b)

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	that was the level that the auditor would have otherwise planned for tests of details had the design or implementation of controls been assessed as ineffective).

Questions for the ASB

2. What are the ASB's views with respect to the requirements and comments summarized above?

Paragraph 18 of AU-C 330

In the ASB comment letter in response to the exposure draft, we included the following comment:

Paragraph 18 of ISA 330 states: “Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.” We believe that this requirement is counterintuitive to, and may undermine the effectiveness of, the risk assessment process in ISA 315, particularly in view of the enhancements being proposed by ED-315. That is, the auditor is required to identify and assess the risks of material misstatement in order to design tailored audit responses. In addition, the stand-back requirement in ED-315 paragraph 52 provides an opportunity to again consider the assessed risks, with a specific focus on material classes of transactions, account balances, and disclosures that the auditor has not identified as significant. If an auditor would be required to perform substantive audit procedures regardless of the assessment of risks of material misstatement under ISA 315, then the objective of performing the work effort under ISA 315 could be questioned. Accordingly, we recommend that paragraph 18 of ISA 330 be eliminated.

However, if the IAASB makes the decision to retain paragraph 18 of ISA 330, then we do not believe the proposed conforming amendments to that paragraph are necessary. ED-315 proposes paragraph 18 of ISA 330 be amended to explicitly state that the auditor’s consideration of materiality includes quantitative and qualitative factors in designing and performing substantive audit procedures for classes of transactions, account balances, and disclosures. We believe that such quantitative and qualitative considerations are inherent in the concept of materiality in the ISAs, and therefore we do not believe that the conforming amendments are necessary.

In addition, if paragraph 18 of ISA 330 is retained, we recommend application material be added to provide guidance as to how the auditor should determine which assertions should be addressed in designing and performing further audit procedures, given that this requirement only applies to classes of transactions, account balances and disclosures that the auditor has determined, through the ISA 315 process, do not contain relevant assertions.

The Task Force thus continues to believe that, given the risk assessment required under AU-C 315, this paragraph is not necessary, notwithstanding the significance of the divergence from ISA 330.

Amendment to AU-C 200

The IAASB proposes to amend AU-C 200 to include the following application material to the definition of Risk of Material Misstatement:

A15a. In determining identified risks of material misstatement, the auditor considers those risks for which a misstatement could be material, and the likelihood that the risk could occur (i.e., whether there is a reasonable possibility that the risk could occur). If there are risks that

could result in a material misstatement and have a reasonable possibility of occurrence and that have not been addressed by the auditor's procedures, then audit risk is not at an acceptably low level. The auditor's judgment is necessary to identify which risks are identified risks of material misstatement.

In the Issues Paper (June 2019), the ISA 315 Task Force explains that in identifying risks in a reasonable assurance engagement, there is an infinite number of possible risks. However, the auditor is not required to identify *all* of these risks to perform procedures to reduce audit risk to an acceptably low level but applies a 'threshold' to the risks that need to be identified. The intent of this proposed conforming amendment is to establish a 'threshold' in identifying the risks of material misstatement.

The Task Force raised the issue that there should be a need to focus on "reasonable possibility of material misstatement"; a misstatement with a reasonable possibility of occurring and a remote (but nonzero) possibility of being material should not be in play.

Questions for the ASB

3. What are the ASB's views with respect to the Task Force's views to eliminate paragraph 18 of AU-C 318? What are the ASB's views with respect to the proposed amendment to AU-C 200?

AU-C 940

The issue of harmonization with AU-C 940 is intertwined with the previous comment related to the consideration of PCAOB standards. With respect to the three items noted above, the ASB adopted the PCAOB's definition of significant accounts and disclosures within the application material of AU-C 940. While integrated audits are not widely performed, those that do perform such audits typically use this definition for both AICPA and PCAOB audits. Do we intend a difference from PCAOB standards? In particular, there is a concern about the lack of clarity around the use of "performance materiality" in the application material. A suggestion would be to elevate the guidance in AU-C 940 to a requirement, similar to PCAOB standards now. This would, however, impact the concept of inherent risk factors. The PCAOB uses the concept of risk factors differently in its list of items to consider for significant accounts and disclosures. Another point here relates to the alignment with COSO. AU-C 940 has a much clearer alignment with the COSO principles (and also incorporates consideration of principles in the Greenbook). We need to consider the impact between ISA 315 and AU-C 940.

Questions for the ASB

4. What are the ASB's views with respect to the interaction between AU-C 315 and AU-C 940?

Appendix

The following table summarizes the Task Force other minor comments or observations.

<p>IT environment – The IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this ISA:</p> <p>(i) An IT application is a program or a set of programs that is used in the initiation, processing, recording and reporting of transactions or information. IT applications include data warehouses or report writers.</p> <p>(ii) The IT infrastructure is comprised of comprises the network, operating systems, and databases and their related hardware and software.</p> <p>The IT processes are the entity’s processes to manage access to the IT environment, manage program changes or changes to the IT environment and manage IT operations., which includes monitoring the IT environment.</p>	<p>The Task Force noted that the addition under subparagraph (i) – is this too specific to specify into the definition, given how quickly IT evolves?</p>
<p>17. The auditor shall <u>design and perform risk assessment procedures to</u> obtain audit evidence that provides an appropriate basis...</p>	<p>The Task Force believes that the reference to “design and perform risk assessment procedures” in the requirement seems redundant given the definition of risk assessment procedures. The Task Force’s suggestion is to eliminate these words and simplify the requirement.</p> <p><i>Risk Assessment Procedures</i> is defined as follows:</p> <p style="padding-left: 40px;">The audit procedures designed and performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.</p>

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<p>23. The auditor shall perform risk assessment procedures to obtain an understanding of:</p>	<p>Although the Task Force recognizes that the drafting of this requirement is in process, the Task Force raised a concern that subparagraph (c) suggests that the auditor would have to understand or identify every inherent risk factor.</p>	
<p>a) The following aspects of the entity and its environment:</p> <p>(i) The entity’s organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT;</p> <p>(ii) Industry, regulatory and other external factors; and</p> <p>(iii) The measures used, internally and externally, to assess the entity’s financial performance; and</p>		<p>(c) How events and conditions are subject to, or affected by, the inherent risk factors in the preparation of the financial statements in accordance with the applicable financial reporting framework.</p>
<p>b) The applicable financial reporting framework, and the entity’s accounting policies and the reasons for any changes thereto.</p>		
<p>24. The auditor shall evaluate whether the entity’s accounting policies are appropriate and consistent with the applicable financial reporting framework.</p>	<p>The Task Force noted that the requirement does not refer to “and any changes thereto” as shown in the proposed application material and is not consistent with ISA 540 (revised). Also, AU-C 315 refers to the <i>reasons</i> for the changes thereto.</p>	

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28. The auditor shall perform risk assessment procedures to obtain an understanding of the control environment through:
(Ref: Para. A105–A114a)

(a) Understanding the set of controls, processes and structures that address:

(i) How management’s oversight responsibilities are carried out, such as the entity’s culture and management’s commitment to integrity and ethical values;

(ii) When those charged with governance are separate from management, the independence of, and oversight over the entity’s system of internal control by, those charged with governance;

(iii) The entity’s assignment of authority and responsibility;

(iv) How the entity attracts, develops, and retains

(b) Evaluating whether:

(i) Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior;

(ii) The control environment provides an appropriate foundation for the other components of the system of internal control; and

(iii) Control deficiencies undermine the other components of the system of internal control.

In sub-paragraph (b), a suggestion is to change *evaluating* to *considering*.

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competent individuals; and		
(v) How the entity holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control.		