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Subject : Response to the IAASB Consultation Paper on the Exposure Draft, ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement

Dear Sir,

The Compagnie Nationale des Commissaires aux Comptes (CNCC) and the Conseil Supérieur de l'Ordre des Experts-Comptables (CSOEC) are pleased to provide you with their comments on the IAASB Exposure Draft, ISA 315 (Revised) (ED-315), Identifying and Assessing the Risks of Material Misstatement.

Significant changes in, and the evolution and increasingly complex nature of, the economic, technological and regulatory aspects of the markets and environment in which entities and audit firms operate, and recent developments relating to internal control and other relevant frameworks have necessitated the proposed revision.

We believe that the changes proposed in the ED ensure the consistency of the general risk assessment process with the one for accounting estimates as included in the new ISA 540. Addressing specific challenges and issues in understanding the entity's system of internal control, providing more guidance during the risk identification and assessment process are welcome in such a context.

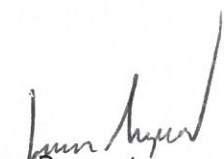
However, we are concerned about certain aspects of the ED, in particular:

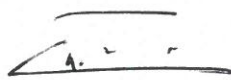
- the length and complexity of the revised standard;
- the use of flowcharts and introductory paragraphs to understand the revised standard;
- key issues that need to be further clarified (e.g. the concepts of likelihood and magnitude, the definition of both "smaller and less complex entities", "closer the upper end of the spectrum of inherent risk");
- the introduction of terminologies from the PCAOB literature (e.g. "more than remote", "reasonable possibility" in the definition of relevant assertions).

Responses to the specific questions raised in the Exposure Draft are set out below.

If you have any further questions about our views on these matters, please do not hesitate to contact us.

Yours faithfully,


Jean Bouquot
President of CNCC


Charles-René Tandé
President of CSOEC

Envoyer obligatoirement toute correspondance aux deux adresses ci-dessous :

Comments

Overall Questions:

Question 1:

Has ED-315 been appropriately restructured, clarified and modernized in order to promote a more consistent and robust process for the identification and assessment of the risks of material misstatement. In particular:

- a) ***Do the proposed changes help with the understandability of the risk identification and assessment process? Are the flowcharts helpful in understanding the flow of the standard (i.e., how the requirements interact and how they are iterative in nature)?***
- b) ***Will the revisions promote a more robust process for the identification and assessment of the risk of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6-28?***
- c) ***Are the new introductory paragraphs helpful?***

We consider that ED-315 provides clarification regarding several aspects of the process for the identification and assessment of the risks of material misstatement, in comparison to the extant standard.

In particular, the new introductory paragraphs help with the understandability of the standard as they set the scene and highlight the iterative nature of the standard. The key concepts developed in the introductory paragraphs are well-written, accessible and understandable; these help the auditor to navigate this complex standard. These three pages of introductory paragraphs accompanied by the 3 flowcharts¹ provide the big picture of the standard.

Although the ED-315 brings helpful clarifications in many areas to the risk identification and assessment process, we consider that the ED includes unnecessary complex and lengthy developments. For example, the ED includes 37 versus 26 requirement paragraphs and 243 versus 155 application and other explanatory material paragraphs in the extant standard.

Moreover, we believe that the standard includes confusing or inconsistent notions with the use, for example, of the concept of “entities that are both smaller and non-complex”, the attributes of “material” and “significant” and their juxtaposition, e.g. not significant but which are material, for classes of transactions, accounts balances and disclosures. Moreover certain definitions are missing, e.g. the notion of “class of transaction”, “account balances”, disclosures” is not defined whereas the term “significant class of transactions” is defined in paragraph (16)).

We note that understanding the risk identification and assessment process appears difficult without the use of flowcharts. These provide visual representations of how the standard should be applied. We consider that the fact that the standard cannot be readily understood without the flowcharts is indicative of undue complexity of the standard. We therefore recommend the IAASB to shorten and simplify the text of the standard to enhance its understandability.

Concerning the separate assessment of inherent risk and control risk, we consider it would be useful to clarify the following:

- The assessment of the risk of material misstatement cannot be higher than the assessment of the inherent risk at the assertion level;
- the assessed risk of material misstatement at the assertion level corresponds to the assessed inherent risk less the assessed control risk.

The flowchart developed in page 20 of the explanatory memorandum indicates: assessed risks of material misstatement at assertion level = IR x CR. This may be confusing.

¹ ISA 315 (Revised) Identifying and assessing the risks of material misstatement, Obtaining an understanding of the entity's system of internal control – ISA 315 (Revised) Para's 25-44, ISA 315 (Revised) – The auditor's understanding of the IT environment and the identification of general IT controls relevant to the audit

Question 2:

Are the requirements and application material of ED-315 sufficiently scalable, including the ability to apply ED-315 to the audits of entities with a wide range of sizes, complexities and circumstances?

In making the proposed revisions with regard to scalability, the IAASB has removed the extant considerations specific to smaller entities sections throughout the standard. Even if we understand that most of the matters previously included in these sections have been retained and built into the text of ED-315 as appropriate, together with further proposed revisions to promote scalability, we consider that this removal does not serve the purpose of scalability. To determine the work effort required for less complex entities, lower risk environment, the auditors have to browse the entire standard to then decide what the requirements applicable to their environment are.

Removing specific considerations relating to smaller entities may lead auditors to performing and documenting more work than actually appropriate in this area, resulting in additional costs without an increase in audit quality. One example of the lack of scalability of the standard is paragraph 29 that states that *“the auditor shall obtain an understanding of the entity’s risk assessment process, including the extent to which it is formalized by understanding (...)”*. The issue is that small entities do not have any formalized risk assessment process.

The extent of work is not clear enough for smaller or less complex entities, especially in terms of extent of consideration of design and implementation of controls in a fully substantive audit.

Moreover, we consider that the concept of “entities that are both smaller and less complex” mentioned in paragraph 13 of the ED-315 is confusing. ISA 200 already defines “small entities” as less complex entities without considering the size criteria. We therefore promote the use of the term “less complex entities” instead of “small entities” and “smaller and less complex entities”. As mentioned in paragraph 13 of the revised standard, the size of an entity may be an indicator of its complexity, some smaller entities may be complex and some larger entities may be less complex. Please note the typo in the footnote 82, i.e. paragraphs of ISA 200 to be mentioned are A66-68 and not 66-68.

Furthermore, we believe that the standard should address the following situations and propose appropriate procedures, i.e. financial statements prepared by a certified public accountant; entities that are component of a group; entities using the services of one or more service organizations.

Finally, we are supportive of the statements of paragraphs A244² and A246³ that confirm the scalability of the documentation.

² We refer to the last sentence of paragraph A244: *“The form and extent of the auditor’s documentation is influenced by the nature, size and complexity of the entity and its system of internal control, availability of information from the entity and the audit methodology and technology used in the course of the audit.”*

³ Paragraph A246: *“For the audits of smaller and less complex entities, the form and extent of documentation may be simple in form and relatively brief. It is not necessary to document the entirety of the auditor’s understanding of the entity and matters related to it. Key elements of understanding documented by the auditor may include those on which the auditor based the assessment of the risks of material misstatement.”*

Question 3:

Do respondents agree with the approach taken to enhancing ED-315 in relation to automated tools and techniques, including data analytics, through the use of examples to illustrate how these are used in an audit (see Appendix 1 for references to the relevant paragraphs in ED-315)? Are there other areas within ED-315 where further guidance is needed in relation to automated tools and techniques, and what is the nature of the necessary guidance?

We agree with the willingness of the IAASB to modernize and update the ISA to make it fit for purpose in today's technological environment. We agree with the approach taken to enhancing ED-315 in relation to automated tools and techniques including data analytics, through the use of examples to illustrate how these are used in an audit.

Nevertheless, we are of the view that the considerations regarding data analytics and automated tools and techniques could be made more visible in the text of the standard. We are of the view that the ED-315 is not disruptive enough and remain old-fashioned with respect to the issue of automated tools and topics. We suggest that the ED further explains how the use of automated tools and techniques, including data analytics, may affect the nature and extent of certain "traditional" risk assessment procedures.

Developing the topic of using data analytics and automated tools and techniques in the application material tends to minimize the importance of using technology tools from the earliest stages of the audit, especially in risk identification and assessment process. We therefore suggest IAASB add a specific point in paragraph 18 (i.e. 18d) to indicate that the risk assessment procedures shall include the data analytics when the engagement team has decided to use automated tools and techniques for its audit.

Question 4:

Do the proposals sufficiently support the appropriate exercise of professional scepticism throughout the risk identification and assessment process? Do you support the proposed change for the auditor to obtain 'sufficient and appropriate audit evidence'⁴ through the performance of risk assessment procedures to provide the basis for the identification and assessment of the risks of material misstatement, and what is the nature of the necessary guidance?

The exercise of professional skepticism, as well as the requirement to assess and obtain sufficient and appropriate audit evidence, are key underlying concepts in auditing. In paragraph 17, the IAASB explains that the purpose of performing risk assessment procedures is to obtain sufficient appropriate audit evidence as the basis for the identification and assessment of the risks of material misstatement. We do not believe that the requirement to obtain sufficient and appropriate audit evidence is within the scope of this project, nor do we believe it is necessary or helpful, and we do not believe it will change behavior. We even believe such a requirement (that consist in obtaining evidence on audit evidence) is confusing and not necessary. It may create unintended consequences as to the scope of some requirements in ISA 500 (Audit Evidence), especially with respect to the requirements to relevance and reliability of audit evidence (ISA 500 para. 7).

The table included on pages 34/35 of appendix 1 to the explanatory memorandum to ED-315 is particularly useful.

⁴ See paragraph 27 of ED-315 Explanatory Memorandum and paragraph 17 of ED-315;
https://www.ifac.org/publications-resources/exposure-draft-isa-315-revised-identifying-and-assessing-risks-material?utm_source=IFAC%20Main%20List&utm_campaign=d45be386a9-SMP_Press_Release_9_14_169_13_2016_COPY_01&utm_medium=email&utm_term=0_cc08d67019-d45be386a9-80451985

Specific Questions

Question 5:

Do the proposals made relating to the auditor's understanding of the entity's system of internal control⁵ assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks of material misstatement? Specifically:

- a) Have the requirements related to auditor's understanding of each component of the entity's system of internal control been appropriately enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?***
- b) Have the requirements related to the auditor's identification of controls relevant to the audit⁶ been appropriately enhanced and clarified? Is it clear how controls relevant to the audit are identified, particularly for audits of smaller and less complex entities?***
- c) Do you support the introduction of new IT-related concepts and definitions? Are the enhanced requirements and application material related to the auditor's understanding of the IT environment, the identification of risks arising from IT and the identification of general IT controls sufficient to support the auditor's consideration of the effect of the entity's use of IT on the identification and assessment of the risks of material misstatement?***

We agree that auditor's understanding of each component of the entity's system of internal control is a prerequisite of assessing control risk during the risk identification and assessment process.

However, in terms of scalability, we consider that assessing the design and implementation of controls is not always necessary to understand each component of the entity's system of internal control system, particularly for entities in a simple and low-risk environment (i.e. small or less complex entities) for which a full substantive audit approach will be adopted.

We consider that the requirement that consists in identifying controls relevant to the audit, evaluating their design and determining whether they have been implemented (paragraph 39e) is of limited value for smaller and less complex entities, since in such context, a fully substantive audit approach will be chosen. We therefore find the requirements of paragraph 39 (e) not necessary since in a smaller/not complex entity environment the auditor will not necessarily need to rely on understanding the controls to identify potential risks. Furthermore, we believe that clarifications are critical and necessary as to:

- what controls "relevant to the audit" are;
- whether "understanding of" is intended to be clearly differentiated from "evaluating the design and implementation of", including the expected form and granularity of documentation.

With regards to paragraph 39 in the ED, we believe that the inclusion of bullet (e) is confusing and duplicative as it seems that bullets (a) to (d) already cover all possible situations. We suggest this bullet be removed.

The introduction of the new IT-related concepts and definitions is helpful for the understanding of the IT environment for larger and more complex entities. However, such concepts may appear to be too complex for smaller and less complex entities. We consider that the standard should further clarify the work to be performed in case of simple and low-risk environment, i.e. small or less complex entities, using especially off-the shelf software packages.

In addition, we are concerned with the introduction of paragraph 36 in the ED that requires the auditor to "evaluate the design of the information system controls relevant to financial reporting"; we believe the exact scope of this requirement and its expected documentation are to be clarified, including in the context of entities where the auditor does not plan to rely on the operating effectiveness of controls.

⁵ See paragraphs 25-44 and A.89-A.200 of ED-315 (ibid)

⁶ See paragraph 39-40 of ED-315 and paragraphs 37-40 of the Explanatory Memorandum (ibid)

Question 6:

Will the proposed enhanced framework for the identification and assessment of the risks of material misstatement result in a more robust risk assessment? Specifically:

- a) *Do you support separate assessments of inherent and control risk at the assertion level, and are the revised requirements and guidance appropriate to support the separate assessments?*⁷
- b) *Do you support the introduction of the concepts and definitions of 'inherent risk factors'⁸ to help identify risks of material misstatement and assess inherent risk? Is there sufficient guidance to explain how these risk factors are used in the auditor's risk assessment process?*
- c) *In your view, will the introduction of the 'spectrum of inherent risk' (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatements, including significant risks?*
- d) *Do you support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures ("SCOTABD"), and their relevant assertions? Is there sufficient guidance to explain how they are determined (i.e. an assertion is relevant when there is a reasonable possibility of occurrence of a misstatement that is material with respect to that assessment)⁹, and how they assist the auditor in identifying where risks of material misstatement exist?*
- e) *Do you support the revised definition¹⁰, and related material, on the determination of 'significant risks'? What are your views on the matters presented in paragraph 57 of the Explanatory Memorandum relating to how significant risks are determined on the spectrum of inherent risk?*
- f) *In your view, will the introduction of the 'spectrum of inherent risk' (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatements, including significant risks?*

We support separate assessment of inherent and control risk at the assertion level and the revised requirements and guidance thereon. This is in line with the approach retained in revised ISA 540.

We support the introduction of the concepts and definitions of "inherent risk factors" to help identify risks of material misstatement and assess inherent risk. The concept of "inherent risk factor" and its definition is consistent with ISA 540. We consider that ED-315 provides sufficient guidance to explain how these risk factors are used in the auditor's risk assessment process.

The IAASB has introduced the concept of "spectrum of risk" to facilitate greater consistency in the auditor's identification and assessment of risks of material misstatement by providing a frame of reference for the auditor's consideration of the likelihood and magnitude of possible misstatements and the influence of the inherent risk factors. However, we think that the concept "spectrum of risk" is not sufficiently explained in the ED-315. It has been introduced by the way of inclusion in a definition, i.e. definition of significant risk as risk close to the upper of the spectrum of inherent risk. We consider that the ED-315 should further clarify the concept of spectrum of risk and how ED-315 applies to the rest of the spectrum of inherent risk (i.e. risk not close to the upper of the spectrum).

In addition, we believe that the IAASB could clarify the following:

- the use of the professional judgment when the auditor determines to place an inherent risk closer to the upper end of the "spectrum of inherent risk";
- the notion of "magnitude" and its potential correlation with the concept of materiality.

Concerning the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures ("SCOTABD") and their assertions, we find the new definitions difficult to read and rationalize. The standard should further clarify the concepts used. Moreover, the terms used in the definition of relevant assertions, i.e. "possibility of occurrence" of a misstatement,"

⁷ See paragraphs 45-50 and A.201-A.235 of ED-315 (ibid)

⁸ See paragraphs 16(f), A.5-A.6 and A.83-A.88 of ED-315 and paragraph 48 of the Explanatory Memorandum (ibid)

⁹ See footnote 26 of the Explanatory Memorandum (ibid)

¹⁰ See paragraphs 16(k), A.10 and A.229-A.231 of ED-315 (ibid)

more than remote” to qualify the likelihood of a material misstatement, may result in an increase in work effort without specific increase in audit quality.

Question 7:

Do you support the additional guidance in relation to the auditor’s assessment of risks of material misstatement at the financial statements level¹¹, including the determination about how, and the degree to which, such risks may affect the assessment of risks at the assertion level?

We do not find that the additional guidance in relation the auditor’s assessment of risks of material misstatement at the financial statements level sufficiently clear and explanatory. This guidance appears superfluous, repeating the requirements in the standard without providing additional guidance.

Question 8:

What are your views about the proposed stand-back requirement in paragraph 52 of ED-315 and the revisions made to paragraph 18 of ISA 330 and its supporting application material? Should either or both requirements be retained? Why or why not?

We support the proposed stand-back requirement in paragraph 52 of ED -315 which is intended to drive a more robust evaluation of the completeness of the significant classes of transactions, account balances and disclosures identified by the auditor.

We consider that the proposed stand-back requirement has more value in ISA 315 than in ISA 330. Having it in both ISA 315 and ISA 330 appears to be redundant. We therefore propose to keep it in ISA 315 only. In addition, we suggest including application material to clarify the extent of expected documentation from this stand-back requirement.

Conforming and consequential amendments

Question 9:

With respect to the proposed conforming and consequential amendments to:

- a) ***ISA 200¹² and ISA 240, are these appropriate to reflect the corresponding changes made in ISA 315 (Revised)?***
- b) ***ISA 330, are the changes appropriate, in the light of the enhancements that have been made in ED-315, in particular as a consequence of the introduction of the concept of general IT controls relevant to the audit?***
- c) ***The other ISAs as presented in Appendix 2, are these appropriate and complete?***
- d) ***ISA 540 (Revised), and related conforming amendments (as presented in the Supplement to this exposure draft)¹³, are these appropriate and complete?***

The revision of ISA 315 will generate consequential amendments on other ISA. Therefore, we consider that before addressing the proposed conforming and consequential amendments from the revision of this standard, key issues in the ED-315 should be resolved as a priority. However as at today, we are supportive of the proposed conforming amendments.

Question 10:

Do you support the proposed revisions to paragraph 18 of ISA 330 to apply to classes of transactions, account balances or disclosures (‘SCOTABD’) that are ‘quantitatively or qualitatively material’ to align with the scope of the proposed stand-back in ED-315?

Since materiality is already understood as having quantitative and qualitative components, we consider that the proposed revisions to paragraph 18 of ISA 330 to apply to classes of transactions, account balances or disclosures (‘SCOTABD’) that are quantitatively or qualitatively material” to align with the scope of the proposed stand-back in ED 315 does not seem essential. Furthermore, we believe that the

¹¹ See paragraphs 47, A.215-A.220 of ED-315 (ibid)

¹² Conforming amendments to ISA 200, paragraph A.42 will be presented with the conforming amendments to ISA 540 (Revised) (ibid)

¹³ Published in July 2018 (ibid)

introduction of the concept of “qualitatively material” may create great confusion and inconsistencies in interpretations. It is not clear how the proposed revisions would be implemented in practice and what would be the impacts in terms of documentation. We consider that the use of professional judgment should be emphasized.

Question 11:

In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters set out below:

- a) Translations – recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-315.*
- b) Effective Date – Recognizing that ED-315 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.*

The complexity of the proposed revised standard could generate potential translation issues. We therefore recommend the IAASB to make efforts to clarify the proposed revised standard. Moreover, the IAASB should ensure that the terminology used in the standard is consistent with the one used in the corpus of standards. Specific examples of terminology used in the standard that should be difficult to translate are in particular “more than remote”, “closer to upper end” since these terms are particularly difficult to represent and conceptualize.

Concerning the effective date of the revised standard, we consider it too soon. We believe it is essential for the IAASB that sufficient time be given to finalize the standard. The IAASB should therefore set a more realistic timeline for revising this standard.