



International Organization of Securities Commissions  
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9 January 2019

Mr. Daniel Montgomery  
Interim Technical Director  
International Auditing and Assurance Standards Board  
529 Fifth Avenue, 6<sup>th</sup> Floor  
New York, New York 10017 USA

**RE: Exposure Draft, Proposed International Standard on Auditing 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement and Proposed Consequential and Confirming Amendments to Other ISAs***

Dear Mr. Montgomery:

The International Organization of Securities Commissions' (IOSCO) Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board's (the IAASB or the Board) Proposed International Standard on Auditing 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement and Proposed Consequential and Confirming Amendments to Other ISAs* (the Paper or ISA 315 (Revised)). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through the promotion of high quality accounting, auditing and professional standards, and other pronouncements and statements.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, disclosure and auditing concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

***Overall Comments***

We are supportive of the IAASB's objective to set high-quality auditing, assurance and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world. Risk

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assessment serves as a critical foundation to the execution of high quality audits and we believe that enhancements to the international auditing standards that promote robust risk assessment practices, with a level of consistency across firms, would contribute favorably to audit quality.

We recognize the Board has spent considerable time and effort on this project and appreciate the opportunity to comment on the Paper. In this letter, we have outlined our views regarding certain topics that have been highlighted within the Paper, including our views and suggestions related to the assessment of inherent risk and the identification of significant risks, where we believe further clarification or guidance would be useful.

We believe it is critical for ISA 315 (Revised) to promote consistency across firms and we have highlighted a number of areas where we believe clarification is essential to avoid potential divergences in interpretation and application by auditors in practice.

We also believe that scalability is essential to the success of the implementation of ISA 315 (Revised). In our comments within this letter, we have highlighted a few areas where it appears the Paper may unnecessarily inhibit scalability. We encourage the Board to continue to consider ways that scalability can be promoted and requirements of the Paper be more succinctly presented.

### ***Assessment of Inherent Risk***

Paragraph 5 of the Paper introduces the concept of the “spectrum of inherent risk” as “the degree to which inherent risk varies.” We agree that a spectrum is an appropriate analogy as the assessment of inherent risk involves numerous considerations and thus an inherent risk can have varying degrees of severity. We are, however, concerned that the Paper does not provide sufficient application and other explanatory material to appropriately promote consistent application by auditors.

As an example, we understand that many auditors have already developed their own categories and metrics related to the assessment of inherent risk. Paragraph A225 of the the Application and Other Explanatory Material provides for auditors to develop their own categories along the spectrum of inherent risk which could vary from one auditor to another (e.g. a numerical scale of 1-10 or a low/medium/high scale). Is this aligned with the Board’s desire to drive consistency in the identification of significant risks? Did the Board consider introducing defined categories of risk to be consistently applied by all firms?

Despite the introduction of a spectrum of inherent risk, the Paper ultimately still results in the identification of only two binary levels of risk; significant or not significant. It is unclear how the Board believes the nature, timing and extent of audit procedures should vary for risks identified on the spectrum that have not been deemed significant. Even if consistency in the classification of risks is achieved through the implementation of ISA 315 (Revised), the responses by auditors in terms of the nature, timing and extent of audit procedures may differ due to the principles-based nature of ISA 330, *The Auditor’s Responses to Assessed Risks* (ISA 330).

We do not believe the limited changes proposed to ISA 330 are sufficient to address the significant changes to ISA 315 (Revised) and would encourage the Board to consider revising ISA 330 and whether a revised ISA 330 should be issued at the same time as ISA 315 (Revised).

### ***Identification of Significant Risks***

We concur with the Board's conclusion to retain the concept of, and the requirement to determine, significant risks given that many of the other ISAs focus on responses to these types of risks. However, we do have concerns that the revised definition of a "significant risk" in the Paper will present application difficulties for auditors in practice.

Paragraph 16(k) of the Paper defines "significant risk" as an identified risk of material misstatement:

- For which the assessment of inherent risk is *close to the upper end of the spectrum of inherent risk* [emphasis added] due to the degree to which one or a combination of the inherent risk factors affect the likelihood of a misstatement occurring or the magnitude of potential misstatement should that misstatement occur; or
- That is to be treated as a significant risk in accordance with the requirements of other ISAs.

This definition represents a shift from paragraph 4(e) of extant ISA 315 which defined a risk as significant when it required "special audit consideration." We agree with the Board's conclusion to focus the definition of a significant risk on the assessment of inherent risk factors rather than the proposed audit response.

Notwithstanding our views on the proposed spectrum of inherent risk, we concur with the Board's view expressed in paragraph 56 of the Explanatory Memorandum to ED-315 (Revised) (the Explanatory Memorandum) that defining significant risks as those risks that are "close to" the upper end of the spectrum, as opposed to "at" the upper end of the spectrum allows for more than one risk of material misstatement to be identified as a significant risk.

However, while paragraph A229 of the Application and Other Explanatory Material provides examples of areas which may rise to the level of a significant risk, our view is that firms would benefit from additional guidance either within the final standard or the Application and Other Explanatory Material for use when considering what risks of material misstatement fall close to the upper end of the spectrum of inherent risk. It is our concern that the notion of "close to the upper end of the spectrum of inherent risk" is too vague and could result in significantly differing judgements made by different auditors even when the profile of a given risk is similar. We are also concerned that there is potential for auditor abuse as it appears that auditors could interpret these requirements in a manner that allows for the minimization of the number of risks ultimately deemed significant.

We also have concerns regarding paragraph A222 of the Application and Other Explanatory Material, which specifically allows for the possibility that a significant risk assessment be made based on different combinations of the likelihood and magnitude of a potential misstatement. For example, the auditor may identify a significant risk in situations where there is a lower likelihood of a material misstatement but if such a misstatement were to occur, it could be of a very high magnitude. This may be confusing to auditors who view the assessment of significant risk on a continuum where the designation of a risk as significant results from the likelihood of a misstatement occurring combined with the magnitude of the potential misstatement.

We believe that it would be useful for the Board to provide additional guidance either in the standard itself or within the Application and Other Explanatory Material to assist auditors in determining whether a

risk is significant for situations where the risk of material misstatement does not include both a high likelihood and a high magnitude of a potential misstatement.

### ***Sufficient Appropriate Audit Evidence***

We support the Board's stated objective within paragraph 15 of the Paper that "the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement."

However, paragraph 27 of the Explanatory Memorandum states what appears to be an expanded objective by stating that "the IAASB has explained that the purpose of performing risk assessment procedures is to obtain *sufficient appropriate audit evidence* [emphasis added] as the basis for the identification and assessment of the risks of material misstatement." This is repeated in paragraph 36 of the Explanatory Memorandum and also included in paragraph 17 of ISA 315 (Revised).

While we support the Board's stated intention to emphasize the need for professional skepticism during the risk assessment process, as stated in paragraph 27 of the Explanatory Memorandum, we question whether using the term "sufficient appropriate audit evidence" to discuss the purpose or objective of risk assessment procedures might cause confusion with how that term is used with regards to the relevance and reliability of audit evidence needed to support the audit opinion. We are also concerned that this presents limitations on the scalability of ISA 315 (Revised) and may result in auditors expending unnecessary resources in obtaining audit evidence to support risk assessment decisions that may not require significant judgment that could be focused elsewhere in the audit.

### ***Relevant Assertions***

We agree with the Board's decision to introduce the concept of "relevant assertions" to focus auditors on those assertions for which there is a reasonable possibility of a misstatement that is material, either individually or in combination with other misstatements. Further, we agree with the Board's decision to use a "reasonable possibility" threshold for identifying relevant assertions.

However, since the identification of relevant assertions is such a critical piece of the proposed risk assessment process, as demonstrated within the flowchart attached to the Paper, we believe that auditors will need clear guidance for how they should apply the "reasonable possibility" threshold when identifying relevant assertions.

Since relevant assertions are those assertions of a relevant class of transactions, account balance or disclosure for which the nature or circumstance of that item has a reasonable possibility of a material misstatement (individually or in combination), one potential way to provide this guidance would be to more clearly link the identification of relevant assertions to the proposed inherent risk factors. We believe this linkage would be appropriate since inherent risk is the susceptibility of an assertion about a class of transactions, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

### ***Substantive Testing for Relevant Assertions***

Some auditors have interpreted paragraph 18 of ISA 330 as not requiring substantive testing for a relevant assertion for a material class of transactions, account balance, or disclosure where the risk of material misstatement is assessed as low, particularly where it is possible to rely on internal controls.

Paragraph 18 of ISA 330 says:

#### ***"Substantive Procedures***

18. 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."

Paragraph A42 of the related application guidance says:

#### ***"Substantive Procedures (Ref: Para. 18)***

- A42. Paragraph 18 requires the auditor to design and perform substantive procedures for each material class of transactions, account balance, and disclosure, irrespective of the assessed risks of material misstatement. This requirement reflects the facts that: (a) the auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and (b) there are inherent limitations to internal control, including management override."

Paragraph 18 of ISA 330 requires the auditor to perform some substantive testing for each material class of transactions, account balance, and disclosure. However, the standard, either currently or as proposed, does not explicitly state that the auditor should perform substantive procedures for all relevant assertions for a material class of transactions, account balance, or disclosure.

In contrast, the auditing standards issued by the Public Company Accounting Oversight Board clearly require the auditor to perform substantive procedures for all relevant assertions of each significant account and disclosure, regardless of the assessed level of control risk. See paragraph 36 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*.

We are concerned that the approach adopted by certain firms may allow for the possibility of material misstatements in a material class of transactions, account balance, or disclosure where a relevant assertion is identified but substantive procedures are not performed.

We acknowledge that the Board has proposed revisions to both paragraph 18 and paragraph A42 of ISA 330 within the Paper and has also proposed adding paragraph A42a, though we do not believe the proposed revisions and additions are sufficiently clear to address the concerns noted above.

### ***Not Significant, but Material***

The Paper addresses classes of transactions, account balances and disclosures that are not significant, but which are material. Paragraph 52 states that the auditor shall:

- a) Identify the classes of transactions, account balances and disclosures that are quantitatively or qualitatively material, and that have not been identified as significant classes of transactions, account balances or disclosures in accordance with paragraph 46; and
- b) Evaluate whether the auditor's conclusion that there are no relevant assertions (that is, no related risks of material misstatement) for these classes of transactions, account balances and disclosures remains appropriate.

Did the Board intend for the language within paragraph 52(b) to imply that circumstances where the auditor does not identify a relevant assertion for a quantitatively or qualitatively material class of transactions, account balance or disclosure should be rare?

Paragraph 52(b) draws a comparison between there being no relevant assertions for a class of transactions, account balance or disclosure as synonymous with there being no related risks of material misstatement. Is this the right threshold or should the terminology used in the definition of a relevant assertion (i.e.: “more than remote”) be used here?

Given the requirements in paragraph 18 of ISA 330 for the auditor to “design and perform substantive procedures for each class of transactions, account balance, and disclosure that is quantitatively or qualitatively material,” we believe that it would be useful for the Board to provide clear discussion and examples within the Application and Other Explanatory Material that illustrate how an auditor might conclude there were no relevant assertions for a class of transactions, account balance or disclosure that was concluded to be material. In essence paragraph 52 of ISA 315 (Revised) seems to contradict with paragraph 18 of ISA 330. We believe the concepts in ISA 330, subject to our concerns above, are more relevant and the more likely scenario.

We observed that the Board has requested comment, in question 8, as to views about the revisions to paragraph 18 of ISA 330 and whether the requirement should be retained. We believe that the revised requirements of this paragraph should be retained, subject to our concerns discussed above, and we encourage the Board to consider whether an unintended consequence of removing this paragraph would be auditors not performing any substantive audit procedures on a material class of transactions, account, or disclosure.

### ***Controls***

We note that paragraph 26 of the Paper indicates that “the auditor shall identify controls relevant to the audit, and shall evaluate the design of such controls and determine whether the controls have been implemented in accordance with the requirements set out in paragraphs 39 to 42.” In other paragraphs of the Paper, the auditor’s requirements are described in the context of obtaining an understanding. For example, paragraph 17(c) indicates that the auditor shall design and perform risk assessment procedures to obtain an understanding of the entity’s system of internal control in accordance with paragraphs 25-44 and other paragraphs also use “obtain an understanding” as the construct compared to evaluate the design of the controls. We are concerned that these inconsistencies in the description of auditor requirements may result in confusion and diversity in practices regarding the consideration of the entity’s system of internal controls and whether understanding of internal controls includes evaluating the design of the controls and whether they are implemented.

Further, we believe that paragraph 39(e) may hinder the scalability of the standard as it appears to encompass a very wide range of controls as relevant to the audit. Specifically, we believe the language in paragraph 39(e)(i) might result in all controls related to relevant assertions of significant classes of transactions, account balances, and disclosures being concluded to be relevant to the audit. As we do not believe this was the Board’s intention, we’d suggest revisiting this paragraph and considering whether it potentially is too all-encompassing.

One example of where we believe the inclusion of “sufficient appropriate audit evidence” as a requirement could be especially problematic is paragraph 17 in regards to the auditor’s consideration of an entity’s system of internal control. While we agree with the Board that obtaining an understanding of the entity’s system of internal control is a critical risk assessment procedure for all audits, we believe the Board should provide more explicit guidance as to the appropriate level of documentation to be obtained in an audit, particularly when the auditor does not intend to test the operating effectiveness of internal controls.

We also noted a few instances, for example paragraph 29 regarding the entity’s risks assessment process and paragraph 35 regarding the information system and communication, where the Paper states that the auditor “shall obtain an understanding” either by or through “understanding.” It is not clear to us what the expectations of the auditor are in these areas and what the corresponding level of audit evidence obtained should be.

Auditors often identify and test higher level and entity level controls, such as the comparison of monthly results of operations to forecasted amounts or prior period amounts. We believe the Board should proactively address the potential for over-reliance on controls of this nature and provide guidance specific to the role of these types of controls in the audit.

Paragraph 16(d) defines controls as “policies or procedures that are embedded within the components of the system of internal control to achieve the control objectives of management or those charged with governance.” It is indicated that policies may be “implied through actions or decisions” and that procedures are actions to implement policies. We are concerned that this imposes a responsibility on the auditor to understand the population of controls beyond what the company has documented, which may not be feasible or appropriate.

Further, as paragraph 16 provides definitions of “controls” and two such types of controls including “general information technology (IT) controls” and “application controls,” we believe the Board should expand the definition of “controls” to include notation of a comprehensive list of types of controls in order to prevent confusion or give the appearance the defined terms are the only types of controls that are relevant to the risk assessment process.

### ***Professional Skepticism***

While the Board intends for ISA 315 (Revised) to respond to calls for more consistent and high quality application of professional skepticism, it is not entirely clear to us in what way the Paper contributes to that objective.

We recognize that Appendix 1 to the Explanatory Memorandum highlights six paragraphs in the Application and Other Explanatory Material where professional skepticism has been addressed. We believe the Board should emphasize the importance of professional skepticism throughout the body of the standard in addition to the Application and Other Explanatory Material.

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss these matters, please contact Doug Niven on ph. +61 2 9911-2079 (email: [douglas.niven@asic.gov.au](mailto:douglas.niven@asic.gov.au)) or Nigel James at ph. + 1 202-551-5300 (email: [jamesN@sec.gov](mailto:jamesN@sec.gov)).

Sincerely,



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