

IAASB Exposure Draft, ISA 315 (Revised),  
*Identifying and Assessing the Risks of Material  
Misstatement*

**Response from the Chartered Institute of  
Public Finance and Accountancy (CIPFA)**

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Any questions arising from this submission should be directed to:

**Don Peebles**

Head of CIPFA Policy & Technical UK  
CIPFA  
Level 3 Suite D  
160 Dundee Street  
Edinburgh  
EH11 1DQ  
Tel: +44 (0)131 221 8653  
Email: [don.peebles@cipfa.org](mailto:don.peebles@cipfa.org)

**Steven Cain**

Technical Manager  
CIPFA  
77 Mansell Street  
London  
E1 8AN  
Tel: +44 (0)20 543 5794  
Email: [steven.cain@cipfa.org](mailto:steven.cain@cipfa.org)

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IAASB Exposure Draft, ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement* and Conforming Amendments to Other ISAs (ED-315)

CIPFA is pleased to present its comments on this Exposure Draft which has been reviewed by CIPFA's Accounting and Auditing Standards Panel.

While the body of ISAs does not have a formal conceptual framework, ISAs 200, 315, 320, 330 and 500 are the key standards which set out what an audit conducted in accordance with ISAs is seeking to achieve, and describe the conceptual basis for that achievement. The other standards mainly elaborate upon these, or set out important practical and governance requirements for auditor conduct and communications. While all standards need to be as clear as possible, it is particularly important that the conceptual material in standards is understandable, as this provides the foundation on which subsequent consideration of detailed application is built.

It is logical for ISA 315 to discuss control risk given that this is a key matter which is relevant to auditor assessments of risks of material misstatement. It is also logical for ISA 315 to provide more discussion of IT controls.

Some of the drafting in ED-315 thus represents a real improvement in explaining how auditors understand audited entity processes and systems, make preliminary assessments of risks, and follow up with possibly repeated cycles of more focused consideration of systems, and consequent reconsideration and assessment of risk.

However, much of the benefit of the improved framing and the new material is lost because its placement in the proposed revised standard reduces understandability. The main body of the standard is overlong and the level of detail is too great. The approach to control risk also appears to be rather mechanistic and framed in language which is more grounded in specific methodology than is appropriate for a standards level discussion. Some parts of the requirements in ED-315 read like a checklist which is not adequately supported by explanation.

In our view the main body of the standard needs to be considerably more concise, providing an understandable basis for the consideration of risk, supported by more detailed application guidance which is appropriately placed.

For the reasons set out above, we consider that IAASB should revisit the placement of the proposals in ED-315, and take the time needed to make the drafting of ISA 315 as clear as possible.

### **Response to questions in the Request for Comment**

Detailed responses to selected questions in the Request for Comment are attached as an Annex.

### Overall questions

**Q1: 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 risks of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6–28?**

**(c) Are the new introductory paragraphs helpful?**

(a) In CIPFA’s view, the main body of the standard is overlong and the level of detail is too great.

As a result the proposed changes do not improve understandability. This is despite the fact that important and helpful content has been added, and many specific matters have been clarified and modernised.

We agree that ISA 315 should discuss control risk given that this is a key matter which is relevant to auditor assessments of risks of material misstatement. The current drafting approach in ISAs is that this is mainly addressed in ISA 200 with some reinforcement in ISA 330 and ISA 530. Mentioning this in ISA 315, and providing more explanation than the current ISAs is in principle helpful.

It is also logical for ISA 315 to provide more discussion of IT controls.

Some of the drafting in ED-315 represents a real improvement in explaining how auditors understand audited entity processes and systems, make preliminary assessments of risks, and follow up with possibly repeated cycles of more focused consideration of systems, and consequent reconsideration and assessment of risk.

However, the proposed revised ISA increases the amount of technical detail in the main body of the standard, so that it is longer and more complex. There is additional material which seeks to make the standard more understandable, but this does not altogether succeed.

The flowcharts are helpful in understanding the flow of the standard, and indeed some readers may find them essential to obtaining a proper understanding. The flowcharts do also reinforce the message that the requirements of risk assessment are iterative in nature.

While the text in the main body of the standard is presented in a logical order which reflects principled thinking on how risk assessment contributes to achieving the objectives of the audit, this is not as apparent as it should be. The increased amount of detail in the requirements means that they read more like a checklist in an audit methodology, setting out what needs to be done without always being clear why this is necessary.

- (b) The revisions may promote a more robust process for identification and assessment of relevant risks, if they are properly understood. However, as drafted, ED-315 may have the opposite effect for some readers of the standard.

The main way in which we can see improvement occurring is if a more understandable version of the (technically good) content is developed by technical units in audit firms, public sector audit institutions, audit training providers and caseware providers. This seems inappropriate – we consider that the ISA should be self standing.

A possible consequence is that the main benefits of the revised standard might apply only to larger audit firms or audit institutions, and perhaps also to auditors of more complex entities. However, we should be clear that we think that the drafting of the standard is currently not optimal, even for these auditors.

- (c) The new introductory paragraphs are helpful in some ways, because they provide more of an overview of the principles which the main body of the standard is seeking to follow. However, we consider that it would be more effective to redraft the main body of the standard in line with our comments in the covering letter

The explanations in the introductory paragraphs are not wholly effective and in some cases add further confusion. This is partly because they are foreshadowing the requirements of the standard, but without using the drafting conventions for requirements. They include explicit statements that ISA 315 requires certain things without fully explaining why they are required. They also include descriptions of the audit process where it is not always clear whether the matters described are true by definition, or because they are true for audits which are carried out in accordance with the requirements of ISAs.

The suggestion that where controls are not tested 'control risk is assessed as a maximum' seems to be an artificial usage which may cause confusion. It would be more natural to explain that if related controls are not tested, control risk cannot be considered to have been assessed, and there can be no reduction in the level of audit work to reflect the benefit of these controls. The work to be done by the auditor will therefore need to address the entirety of the inherent risk, which must be assessed separately.

We also suggest that the material on skepticism could be better placed to reflect its overarching nature, rather than interrupting the discussion of concepts relevant to the risk assessment model.

**Q2: 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?**

The proposals focus on the level of complexity rather than size, and may help with the totality of understanding by providing a more detailed discussion of how risks may not apply to less complex entities.

However, as explained in our response to question 1, the main body of the standard is over long and contains too much detail. Putting more of this material in Application Guidance would make the standard more readable, while facilitating more focused reading of the more detailed material, having regard to those aspects of the material which are fully, partially or not relevant to the entity being audited.

**Q3: 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?**

CIPFA is content with this approach.

**Q4: Do the proposals sufficiently support the appropriate exercise of professional skepticism throughout the risk identification and assessment process? Do you support the proposed change for the auditor to obtain 'sufficient appropriate audit evidence' through the performance of risk assessment procedures to provide the basis for the identification and assessment of the risks of material misstatement, and do you believe this clarification will further encourage professional skepticism?**

CIPFA is content with this approach. We have supported the Board's various proposals for signposting the need for appropriate scepticism in ISAs. However, we do not consider that there were significant deficiencies in the body of ISAs before these proposals, nor do we consider that the ISAs are the main drivers for auditor improvement.

CIPFA agrees that the risk assessment process is part of the overall audit process of gathering sufficient appropriate audit evidence. The proposed revisions provide clarification, but in line with our other comments, we are not sure this will significantly affect the degree of scepticism exercised by auditors.

**Specific questions**

**Q5: Do the proposals made relating to the auditor's understanding of the entity's system of internal control 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 the 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 audit 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 the 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 the risks arising from IT and the identification of general IT controls sufficient to support the auditor's consideration of the effects of the entity's use of IT on the identification and assessment of the risks of material misstatement?**

(a) The proposed revised ISA contains new material related to the auditor's understanding of internal control. As noted in the covering letter, CIPFA considers that the main body of the standard contains too much detail: in consequence it may be less successful in explaining why the auditor needs to obtain an understanding and how this relates to the identification and assessment of the risks of material misstatement

(b) Notwithstanding our comments on placement, the proposed revisions include enhanced and clarified material.

(c) In line with our responses to Question 1, CIPFA considers that much of this material would be better placed in application material.

**Q6: 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’?**

**(b) Do you support the introduction of the concepts and definitions of ‘inherent risk factors’ 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 misstatement, 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, 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 assertion), and how they assist the auditor in identifying where risks of material misstatement exist?**

**(e) Do you support the revised definition, 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?**

(a) CIPFA supports the separate assessment of inherent and control risk.

(b) CIPFA supports the concept of inherent risk factors

(c) CIPFA is content with the concept of spectrum of risk. Even in approaches which take a discrete (e.g. high, medium, low) approach, there is an implicit spectrum, and care has to be taken where judgements are at the top and bottom ends of risk categories.

(d) CIPFA supports the new concepts in relation to significant classes and relevant assertions, which help with the identification of what is most important for the audit work.

However, CIPFA considers that the meaning of the term ‘reasonably possible’ in an audit context is unclear. Outside of its defined usage in US GAAP financial reporting it is not clear that ‘reasonably possible’ equates to risks which are ‘more than remote’, and this may result in confusion and inconsistent interpretation.

(e) The revised definition of significant risk is probably an improvement.

**Q7: Do you support the additional guidance in relation to the auditor's assessment of risks of material misstatement at the financial statement level, including the determination about how, and the degree to which, such risks may affect the assessment of risks at the assertion level?**

More work is required on this guidance. CIPFA agrees that ED-315 provides more information on the nature of risks of material misstatement at financial statement level, but more clarity is needed on how these relate to the assessment of risks at the assertion level.

**Q8: 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?**

CIPFA agrees that the proposed stand-back requirement in paragraph 52 of ED-315 is helpful. In our view both requirements should be retained.