

5 November 2018

Dan Montgomery
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International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor
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USA

Dear Sir,

RESPONSE TO THE INTERNATIONAL AUDITING AND ASSURANCE STANDARDS BOARD (IAASB) EXPOSURE DRAFT (ED) - PROPOSED INTERNATIONAL STANDARD ON AUDITING (ISA) 315 (REVISED) *IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT* AND PROPOSED CONSEQUENTIAL AND CONFORMING AMENDMENTS TO OTHER ISAS

The Institute of Singapore Chartered Accountants (ISCA) appreciates the opportunity to comment on the above ED issued by the IAASB in July 2018.

To solicit meaningful feedback for this ED, the Institute of Singapore Chartered Accountants (ISCA) sought views from its members through a one-month public consultation process and discussed the ED with members of the ISCA Auditing and Assurance Standards Committee.

Our comments to selected questions in the ED are as follows:

Overall Questions

- 1) Has ED-315 been appropriately restructured, clarified and modernised 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?

- 1.1 We support the overall direction of the proposed revisions made to ISA 315. We believe that the IAASB has focused revisions in the right areas, including enhancements to drive consistent and effective identification and assessment of risks of material misstatement, embedding scalability considerations, modernising the standard, and emphasising on professional scepticism.
- 1.2 The introductory paragraphs in ED-315, together with the flowcharts, provide a good summary of the flow of the auditor's risk assessment process, thereby providing overall context for the structure of the standard. We recommend that the flowcharts, which currently accompany the Explanatory Memorandum, be included either together with the introductory summary or as an Appendix to the standard. We believe that diagrammatic representations will help enhance the auditor's understanding of the risk assessment process.
- 1.3 We also suggest that Appendix 1 of the Explanatory Memorandum be included as part of the standard so that auditors can quickly reference to the relevant paragraphs of interest.
- 1.4 However, overall, the standard may be too lengthy, and the sentences within certain paragraphs are also too long, which make it difficult to read and understand. While we appreciate that the application and explanatory materials are meant to give further guidance on how the requirements can be applied, voluminous guidance may instead have negative impact on the readers. The IAASB may wish to consider the following suggestions:
 - Use of shorter and more concise sentences.
 - Use of acronyms. Many of the terms used are long and mentioned throughout the standard. For example, "COTABD" can be used in place of "classes of transactions, account balances and disclosures", and "RoMM" can be used in place of "risks of material misstatements".
 - Review and remove application material that may not be important or are better placed and illustrated through case studies in a separate publication.
- 1.5 In addition, to promote greater understanding and consistent application, we suggest that the IAASB consider developing separate staff publications covering the practical implementation aspects. For example, case studies could be used to demonstrate the application of paragraph A16 of ED-315, as to the nature and extent of the required understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control. This enables auditors to better appreciate the extent of understanding required, especially where the audited entity is smaller and less complex.

Specific Questions

- 5) 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 or 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?

Clarity with Respect to Auditor's Understanding of Entity's System of Internal Control

- 5.1 ED-315 stipulates the specific matters relating to each component of internal control that auditors need to understand. We are of the view that in general, these requirements have been appropriately enhanced. We have identified areas that need further clarification in the subsequent paragraphs.
- 5.2 We believe that further clarification is needed on why this understanding of the entity's system of internal control is required and how the information obtained is to be used as part of risk assessment. This is especially so when a primarily substantive audit approach is adopted. For example, paragraph A102 of ED-315 could be further enhanced to demonstrate how understanding the information system and control activities can affect the identification and assessment of risks of material misstatement at the assertion level.
- 5.3 There may be potential confusion between the controls in the "information system and communication" component (information system controls) and controls in the "control activities" component. As provided in paragraph A160 of ED-315, controls in the "control activities" component include those controls over the flows of information within the information system relating to significant classes of transactions, account balances and disclosures and the financial reporting process used to prepare the financial statements. This would imply that information system controls and controls in

the “control activities” component are inter-related. In fact, we would think that controls in the “control activities” component that are relevant to audit are a sub-set of the “information system controls”.

- 5.4 However, as the controls are described under different components of the system of internal control, it conveys the impression that they are distinct. Also, the auditor is required, in paragraph 36, to evaluate the design and implementation of information system controls, and in paragraph 42, to evaluate the design and implementation of controls in the “control activities” component, if they are relevant to audit.
- 5.5 Greater clarity is hence required on how “information system controls” interplay with or are distinct from controls in the “controls activities” component. Clarity is required on whether controls in the “control activities” component are a sub-set of the “information system controls” and hence subject to evaluation of design and implementation in paragraph 36 of ED-315. If they are a sub-set, this may contradict with paragraph 42 of ED-315 which only requires the evaluation to be performed for those controls which are relevant to the audit.
- 5.6 This lack of clarity also raises questions as to the nature and extent of understanding of the entity’s IT environment required in paragraph 35(d) of ED-315. This understanding, together with the identification of controls relevant to audit, form the basis for the identification of IT applications and other aspects of the entity’s IT environment that are relevant to the audit. It is unclear whether general IT and application controls that are not identified as relevant to audit are also subject to evaluation of design and implementation as required in paragraph 36 of ED-315.
- 5.7 In addition, as shared by the IAASB in paragraph 46 of the Explanatory Memorandum, a deficiency in internal control may arise within any of the components of the entity’s system of internal control. Hence, the IAASB has added overarching requirements in paragraphs 43 and 44 of ED-315 for the auditor to determine, on the basis of work performed under the standard (i.e. all the components of the system of internal control), whether any control deficiencies have been identified and to evaluate the implications on the audit. Accordingly, we are of the view that paragraph 31(b) of ED-315 that requires identification of control deficiencies specifically under the “entity’s risk assessment process” component is not required.
- 5.8 The IAASB may also wish to revisit sub-points 1 and 5 of paragraph A136 of ED-315. These points appear to be repetitive as both cover the capturing and processing of information about events and conditions other than an entity’s transactions.

IT-Related Concepts and Definitions

- 5.9 We support the introduction of the new IT-related concepts and definitions. We believe identifying risks arising from the entity’s use of IT is necessary in today’s environment. We are of the view that the IAASB should continue to monitor and assess the impact of entities’ use of IT on audits of financial statements, and provide timely and relevant guidance.

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:

(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?

Definition of "Relevant Assertion"

6.1 The proposed definition of "relevant assertion" is complex and confusing. It does not reflect how relevant assertions are being described in ED-315, which are simply assertions for which there are one or more risks of material misstatement.

Determination of Significant Risks

6.2 We are of the view that, in the determination of significant risks, both the likelihood of a misstatement occurring, and the magnitude of potential misstatement should be considered. The combination of likelihood and magnitude will help determine whether the assessed risks are close to the upper end of the spectrum of inherent risk and are therefore significant risks. Based on the proposed definition of "significant risk" in paragraph 16(k) of ED-315, it would appear that a high likelihood or a high magnitude alone can result in a significant risk.

6.3 There are many possible risks that an entity would face that may have severe consequences. Taking into consideration that the determination of significant risks only considers inherent risks and does not take into account related controls, the proposed definition of "significant risk" may lead to a disproportionately high number of significant risks being identified.

- 7) 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?

Risks of Material Misstatement at the Financial Statement Level

- 7.1 For assessed risks of material misstatements at the financial statement level, the IAASB could clarify if the auditor needs to determine whether any of these risks are significant risks.
- 7.2 Based on paragraphs 47 and 49 of ED-315, it would appear that the auditor would not need to make this determination. The auditor is only required to determine how, and the degree to which, such risks affect the assessment of risks of material misstatement at the assertion level and to evaluate the nature and extent of their pervasive effect on the financial statements.
- 7.3 In comparison, paragraph 25 of ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* requires the auditor to identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. Paragraph 27 of ISA 240 further requires the auditor to treat those assessed risks of material misstatement due to fraud as significant risks. For example, management override of controls is a risk of material misstatement at the financial statement level and is required in paragraph 31 of ISA 240 to be considered as a significant risk.
- 7.4 Hence, the clarity should be enhanced to reconcile the requirements in ISA 315 and ISA 240.
- 7.5 In addition, we suggest that the IAASB provides examples of risks of material misstatement that can exist at the financial statement level, and to demonstrate how the suggested overall audit responses in paragraph A1 of ISA 330, *The Auditor's Responses to Assessed Risks* can address such risks of material misstatement. In practice, only the risk of management override of controls would be typically identified as a risk of material misstatement at the financial statement level.
- 7.6 Paragraph A1 of ISA 330 provides suggested overall responses that the auditor could implement to address risks of material misstatement at the financial statement level. The IAASB may wish to consider making reference to paragraph 29 of ISA 240 which stipulates the responses required when these assessed risks are due to fraud.

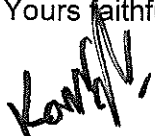
- 8) What are your views about the proposed stand-back requirement in paragraph 52 of ED-315 and the revisions made to paragraph 18 of ISA 330 and its supporting application material? Should either or both requirements be retained?
- 10) Do you support the proposed revisions to paragraph 18 of ISA 330 to apply to classes of transactions, account balances or disclosures that are 'quantitatively or qualitatively material' to align with the scope of the proposed stand-back in ED-315?

Stand-Back Requirement and Paragraph 18 of ISA 330

- 8.1 Given that many of the risk assessment steps are performed concurrently, which necessitates the auditor continually updating their understanding and re-considering their assessments, we believe that overall it is helpful to have a stand-back requirement at the end of the risk assessment process to drive completeness of identification of risks of material misstatement, before the auditor proceeds to the execution of responses. We note that the stand-back requirement in paragraph 52 of ED-315 also flows well into paragraph 53 which reminds auditors that the assessment of risk may change as additional evidence is obtained.
- 8.2 For the proposed revisions to paragraph 18 of ISA 330 and its related supporting application material, we are not sure how substantive procedures on the material transaction, account balance or disclosure can be designed in a risk-based audit approach when there is no risk of material misstatement being identified (i.e. the transaction, account balance or disclosure is not significant). Having this requirement to carry out more audit procedures may also diminish the significance of the risk identification and assessment process as a critical part of the audit process, and undermine the importance of professional scepticism during the risk assessment phase. Hence, we would suggest removing this proposed requirement (second sub-point of paragraph A42 of ISA 330).
- 8.3 Nevertheless, we support the retention of the requirement to perform substantive procedures for every significant class of transaction, account balance or disclosure. This is to safeguard against the approach where tests of controls for significant classes of transactions, account balances and disclosures are the only further audit procedures performed.

Should you require any further clarification, please feel free to contact Mr Kang Wai Geat, Deputy Director, Audit Quality & Standards Development, or Ms Fua Qiu Lin, Senior Manager, Audit Quality & Standards Development, at ISCA via email at waigeat.kang@isca.org.sg or qiulin.fua@isca.org.sg respectively.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Fann Kor', written over the closing 'Yours faithfully,'.

Ms Fann Kor

Director

Audit Quality & Standards Development, Continuing Professional Education and Industry Support