

Basis for Conclusions
Prepared by the Staff of the IAASB
October 2019

*International Standard on Auditing 315 (Revised
2019)*

Identifying and Assessing the Risks of Material Misstatement

Including Conforming and
Consequential Amendments to
Other International Standards

About the IAASB

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The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related services 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 and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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International Auditing
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BASIS FOR CONCLUSIONS: ISA 315 (REVISED 2019), IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT, INCLUDING CONFORMING AND CONSEQUENTIAL AMENDMENTS TO OTHER INTERNATIONAL STANDARDS¹

The Staff of the International Auditing and Assurance Standards Board (IAASB) has prepared this Basis for Conclusions. It relates to, but does not form part of, ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*, or the conforming and consequential amendments to other International Standards.

ISA 315 (Revised 2019) was approved with affirmative votes of 15 out of 18 IAASB members, and the conforming and consequential amendments to other International Standards were approved with the affirmative votes of 16 out of 18 IAASB members.²

Introduction

Background

1. The project to revise ISA 315 (Revised)³ commenced in early 2016 to respond to key findings from the IAASB's ISA Implementation Monitoring Project.⁴ The post-implementation review was completed in 2013, and key and significant findings in relation to ISA 315 (Revised) included that:
 - Inconsistency existed in the nature and number of significant risks identified in practice.
 - Obtaining an understanding of the system of internal control was difficult to apply in practice.
 - Information Technology (IT) risks were not sufficiently addressed in the standard.

The post-implementation review also highlighted the challenges of applying ISA 315 (Revised) when auditing small- and medium-sized entities (SMEs).

2. Consultations in the development of the IAASB's Strategy for 2015–2019: *Fulfilling Our Public Interest Mandate in an Evolving World*⁵ and related Work Plan for 2015–2016: *Enhancing Audit Quality and Preparing for the Future*⁶ also supported further information gathering and work to address the issues that had been highlighted relating to ISA 315 (Revised). This input, along with information about reports of inspection findings from audit regulatory bodies consistently noting findings with respect to risk identification and assessment, highlighted risk identification and assessment as an important area where further enhancements were needed to drive improved audit performance.

¹ The IAASB's International Standards comprise the International Standards on Auditing (ISAs), the International Standards on Review Engagements (ISREs), the International Standards on Assurance Engagements (ISAEs), and the International Standards on Related Services (ISRSs).

² For a full record of the voting on ISA 315 (Revised), including the rationale of the IAASB members who voted against the standard and who abstained from the vote, see <https://www.iaasb.org/meetings/iaasb-board-meeting-new-york-usa-0>.

³ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

⁴ [Clarified International Standards on Auditing—Findings from the Post-Implementation Review](#)

⁵ https://www.ifac.org/system/files/publications/files/IAASB-Strategy-2015-2019_0.pdf

⁶ <https://www.ifac.org/system/files/publications/files/IAASB-Work-Plan-2015-2016.pdf>

3. In the first half of 2016, the IAASB discussed the scope of a project to revise ISA 315 (Revised), which included consideration of the findings from audit regulatory bodies, the findings of the IAASB's post-implementation review of the clarified ISAs, as well as changes in the environment that would necessitate changes in ISA 315 (Revised). During this process, various outreach activities, in particular with audit regulatory bodies, firms and those representing small- and medium-sized practices (SMPs), were also undertaken to help identify issues relating to ISA 315 (Revised). This outreach helped with identifying additional feedback about challenges and issues experienced in practice, including helping the IAASB better understand the specific challenges when applying ISA 315 (Revised) in an audit of a SME.
4. The IAASB approved a project proposal⁷ to revise ISA 315 (Revised) in September 2016 with the following objectives:
 - To propose revisions to ISA 315 (Revised), establishing more robust requirements and appropriately detailed guidance to drive auditors to perform appropriate risk assessment procedures in a manner commensurate with the size and nature of the entity. It was anticipated that these revisions would focus on enhancing the auditor's approach to understanding the entity, its environment (including its internal control) and risk assessment activities in light of the changing environment.
 - To determine whether and how ISA 315 (Revised), in its organization and structure, could be modified to promote a more effective risk assessment.
 - To propose consequential amendments to other standards that may be necessary as a result of revisions to ISA 315 (Revised) (such as ISA 220⁸, ISA 240⁹, ISA 330¹⁰, ISA 540 (Revised)¹¹ and ISA 600).¹²
 - To determine what non-authoritative guidance and support tools should be developed by the IAASB, or others, to supplement revisions to ISA 315 (Revised) thereby aiding its effective implementation. Non-authoritative guidance and support tools may include International Auditing Practice Notes (IAPNs), Staff publications, project updates, or illustrations / examples to provide assistance on how ISA 315 (Revised) could be applied, in particular to address concerns by auditors of SMEs.
5. At its June 2018 meeting, the IAASB approved proposed ISA 315 (Revised) (ED-315) for public exposure, including related conforming and consequential amendments to other International Standards. ED-315 was published on July 16, 2018 for comment by November 2, 2018. Comment letters were received from 72 respondents, including regulators and audit oversight authorities, national auditing standard setters, accounting firms, public sector organizations, International

⁷ http://www.iaasb.org/system/files/meetings/files/ISA-315-Revised-Project-Proposal_Final-September-2016.pdf

⁸ ISA 220, *Quality Control for an Audit of Financial Statements*

⁹ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

¹⁰ ISA 330, *The Auditor's Responses to Assessed Risks*

¹¹ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

¹² ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Federation of Accountants (IFAC) Member Bodies and other professional organizations, academics and individuals. Responses were received from four Monitoring Group members.¹³

Public Interest Issues

6. The table below shows the public interest outcomes identified by the IAASB in the project proposal, and the subsequent decisions made to enhance the standard in the public interest, taking into account the comments received in response to ED-315 (paragraph references in this table are to ISA 315 (Revised 2019)).

Public Interest Issues	IAASB Decisions
<p>Enhancing the auditor’s approach to risk assessment in recognition of the changing environment.</p> <ul style="list-style-type: none"> • A well-informed risk assessment is critical to audit quality. A robust risk assessment is fundamental to the audit process and is critical for the auditor in designing an audit strategy and approach that will be responsive to the assessed risks of material misstatement: <ul style="list-style-type: none"> ○ Because of changes in the environment, including financial reporting frameworks becoming more complex, technology being used to a greater extent, and entities and their governance structures becoming more complex, risk identification and assessment needs to be more rigorous and more comprehensive. ○ Automated tools and techniques are increasingly being used to inform auditor’s risk assessment but the current ISAs do not specifically address the potential benefits and implications of using these tools in an audit of financial statements, including for purposes of performing risk assessment procedures. 	<p>The IAASB responded by:</p> <ul style="list-style-type: none"> • Separating and enhancing the requirement to obtain an understanding of the applicable financial reporting framework, to encourage an increased focus on the entity’s financial reporting requirements (see paragraph 19(b)). • Significantly enhancing the auditor’s considerations in relation to the entity’s use of IT and the impact of this on the audit (see paragraphs 19(a)(i)), 25(a)(iv), 26(b) and (c), A140–A143, A166–A174 and Appendices 5 and 6), and including new¹⁴ and revised IT-related definitions (see paragraphs 12(d), 12(e), 12(g) and 12(i)). • Enhancing and clarifying the auditor’s understanding of the entity’s organizational structure, ownership and governance, business model and business risks (see paragraphs A56–A67) • Enhancing and clarifying the auditor’s understanding of the entity’s control environment and how this forms a foundation for the rest of the entity’s system of internal control (see paragraphs 21 and A99–A108). • Where appropriate, introducing specific considerations relating to the auditor’s use of automated tools and techniques (see

¹³ The Monitoring Group comprises the Basel Committee on Banking Supervision (BCBS), the European Commission, the Financial Stability Board, the International Association of Insurance Supervisors (IAIS), the International Forum of Independent Audit Regulators (IFIAR), the International Organization of Securities Commissions (IOSCO) and the World Bank. Responses to ED-315 were received from BCBS, IAIS, IFIAR, and IOSCO.

¹⁴ A new definition for ‘risks arising from IT’ has been introduced from what was presented in ED-315; the other IT-related definitions have been revised from what was introduced in ED-315.

<ul style="list-style-type: none"> ○ There are increasing expectations that auditors will appropriately focus on judgmental and complex areas in the financial statements. 	<p>paragraphs A21, A31, A35, A57, A137, A161, A203).¹⁵</p> <ul style="list-style-type: none"> ● Introducing the concept of inherent risk factors, including complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk, to assist the auditor in identifying risks of material misstatement, and when assessing those risks (see paragraphs 12(f), 19(c), 31(a), A7–A8, A85–A89, A210 and Appendix 2).
<p>Enhancing the application of professional skepticism in audits</p> <ul style="list-style-type: none"> ● Professional skepticism is a fundamental concept and core to audit quality: <ul style="list-style-type: none"> ○ Audit regulatory bodies highlighted significant concerns about how auditors, in some instances, are performing risk assessment procedures where professional skepticism does not appear to have been appropriately applied. ○ Feedback from consultations of the IAASB highlighted that it is more difficult for auditors to apply appropriate professional skepticism if they do not have a sufficient understanding of the entity and its environment. 	<p>The IAASB responded by:</p> <ul style="list-style-type: none"> ● Introducing a requirement to design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory (paragraph 13). ● Introducing a requirement to ‘stand-back’ once the risk assessment procedures have been performed, by taking into account all audit evidence obtained from risk assessment procedures, whether corroborative or contradictory to assertions made by management to evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement (paragraph 35). ● Using more explicit language and enhancing application material to reinforce the importance of exercising professional skepticism when performing risk assessment procedures (see, for example, paragraphs A12, A13, A14, A42, A43, A50, A88, A232 and A238).

¹⁵ The publication of final ISA 315 (Revised 2019) will be accompanied by non-authoritative guidance prepared by the IAASB’s Technology Working Group (in the form of Questions and Answers) to further support the use of automated tools and techniques when performing risk assessment procedures using the extant ISAs.

<p>Responding to other feedback on areas for improvement</p> <ul style="list-style-type: none"> • Challenges have been identified relating to scalability when performing risk assessment procedures to identify and assess the risks of material misstatement in audits of SMEs, in particular related to the entity’s system of internal control. • Concerns have been expressed about too much subjectivity in the determination of what a significant risk is in practice, which consequently results in a failure to properly address such risks of material misstatement in planning and performing the audit. This in turn may result in failure to obtain sufficient appropriate audit evidence, or identify one or more misstatements that might be material, individually or in the aggregate. • Challenges have been identified relating to obtaining an understanding of internal control and control activities “relevant to the audit,” which it was noted was subject to differing interpretations and inconsistent practice. These challenges include the nature and extent of work to be undertaken to demonstrate the required ‘understanding.’ • A need was identified for the standard to address evolving business and operational models and related entity structures, such as the use of shared service centers and integrated IT systems. 	<p>The IAASB responded by:</p> <ul style="list-style-type: none"> • Enhancing the auditor’s considerations related to scalability (see paragraphs 9, A16, A33, A44–A45, A52–A55, A78, A92, A99–A100, A113, A114–A115, A131, A144–A145, A156–A157, A170–A171, A239–A241). • Clarifying the nature and extent of work to be performed when obtaining an understanding of each of the components of the entity’s system of internal control, in particular adding specificity with regard to the controls for which an understanding is required in the control activities component (see paragraphs 21–26 and A90–A183). • Introducing the concept of a spectrum of inherent risk; • Clarifying the definition of significant risk and explaining how it is to be applied through the concept of a spectrum of inherent risk (see paragraphs 5, 12(l), A10, A125, A208–A214 and A218–A221) • Clarifying the link between the identification and assessment of risks of material misstatement and responses to the assessed risks (see paragraphs 7–8, A85–A86, A97–A98, A125, A131, A151, A185, A193 and A230). • Enhancing and clarifying the auditor’s understanding of the entity’s organizational structure, ownership and governance, business model and business risks (see paragraphs A56–A67) • Enhancing the auditor’s considerations in relation to the entity’s use of IT and its impact on the audit, including in relation to integrated IT systems as well as less complex IT systems (see paragraphs 19(a)(i), 25(a)(iv), A140–A143, A166–A174 and Appendices 5 and 6), and including new and revised IT-related definitions (see paragraphs 12(d), 12(e) 12(g) and 12(i)).
<p>Supporting a robust, principles-based standard with additional guidance to aid in its effective implementation</p> <ul style="list-style-type: none"> • While revisions to ISA 315 (Revised) are clearly necessary, feedback obtained has 	<p>The IAASB responded by:</p> <ul style="list-style-type: none"> • Enhancing the application material and appendices where appropriate, adding explanations of ‘why’ procedures are required to help the auditor’s understanding when applying

<p>also indicated that more support (such as the development of non-authoritative guidance by the IAASB) would be helpful to achieve the intended objectives of the project.</p>	<p>the requirements, and organizing the application material in a clearer way (for example, using clear subheadings and placing examples in boxes).</p> <ul style="list-style-type: none">• Committing to a plan to publish implementation guidance and Frequently Asked Questions, and other related activities to support implementation by September 2020.
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7. The Appendix to this document shows how the IAASB addressed the list of public interest issues related to the project to revise ISA 315 (Revised) that were provided to the IAASB by the Public Interest Oversight Board (PIOB). These issues were identified from observation activities by PIOB members and from analyses carried out by PIOB staff. Most of these issues were raised by PIOB observers during the course of meetings attended.

Understandability, Complexity and Length of the Standard

Background

8. Notwithstanding that the ISAs are written in a linear manner, many aspects of ISA 315 (Revised) are interconnected in nature and are often in practice performed in an iterative manner. The IAASB recognizes the importance, and also the complexity, of the auditor's risk assessment process, and changes were proposed in ED-315 to explain the iterative nature of the standard. The new introductory paragraphs provided overall context for the structure of the standard. In addition, flowcharts to support the implementation of the standard were published with ED-315.

Summary of Comments Received on Exposure

11. Notwithstanding support for various aspects of ISA 315 (Revised) that had been revised, pervasive themes noted by respondents to ED-315 included:
- The proposed changes had introduced a level of complexity that made the flow of the standard difficult to understand and therefore difficult to apply, in particular through requirements that were too prescriptive;
 - The increased length, language used, and structure had made the standard more difficult to understand;
 - The use of new concepts and definitions, some of which lacked clarity, made the standard more difficult to apply and in some cases were not reflected in ISA 330;¹⁶ and
 - That the iterative nature of the standard was not clear.

Respondents also encouraged the IAASB to simplify the identification and assessment of the risks of material misstatement.

IAASB Decisions

12. The IAASB adopted an approach to clearly identify the key elements of what the requirements require the auditor to do, while also promoting and maintaining consistency in their application. In making broader

¹⁶ ISA 330, *The Auditor's Responses to the Assessed Risks*

changes, the IAASB retained the concepts that were exposed in ED-315, but made changes for clarity and consistent application. Specifically, the IAASB:

- Used simpler, more straightforward language for each requirement.
 - Combined or separated requirements, as appropriate, to enhance their understandability.
 - Presented the requirements at a higher level and focused them on “what” has to be done, with additional explanation in the application material of “why” the procedures are required (including, where applicable, criteria previously within the requirement not considered significant to the ‘what’).
 - Addressed “how” a requirement may be executed elsewhere in the standard (for example, considering what further can be included in application material and appendices).
 - Where appropriate, drafted requirements using a consistent wording construct (for example for each of the components of the system of internal control) so that requirements with consistent approaches are read as intended..
 - Reduced cross-referencing within the requirements to reduce complexity.
 - Addressed perceived inconsistencies in terms to avoid inconsistency in their application.
13. With regard to the application material, in addition to similar actions as described above, the IAASB also:
- Enhanced the supporting application material, as relevant, to explain ‘why’ a particular requirement exists.
 - Placed examples within boxes to separately identify them and enhanced the examples as appropriate.
 - Moved guidance explaining aspects related to the entity’s business and components of internal control (rather than considerations on how the auditor applies their understanding of these when executing the requirements) to the Appendices.
 - Removed guidance better suited to implementation guidance.
 - Removed language that repeated the requirement.
 - Reconsidered, and revised where possible, long and complicated sentences and paragraphs.
 - Inserted section headings within the application material in a consistent way so that users of the standard are able to more easily navigate the standard.

The Appendices were also revised accordingly.

Iterative Nature of the Standard

Background

14. There have been ongoing concerns expressed about the order of the requirements, as there are interdependencies between certain requirements, such that the execution of certain requirements that are presented earlier in the standard have dependencies upon the execution of other requirements that are presented at a later stage.

IAASB Decisions¹⁷

15. The IAASB considered whether to change the ordering of the requirements in the standard to be more representative of how some of the concepts within the standard interact. However, in doing so, the IAASB had the view that this created other (unintended) consequences. Therefore, the IAASB continues to have the view that the order in which the requirements are presented, although linear, is still the most effective presentation, including to keep risk identification and assessment requirements in a common section.
16. To support and explain the iterative nature of the standard, new application material has been developed (paragraphs A126–A130) to provide context for the iterations that are required. In particular, these explain the iterative nature of:
 - Determining significant classes of transactions, account balances and disclosures, including for the purpose of understanding the entity’s information system.
 - Identifying and evaluating controls in the control activities component for which their identification is based on the identification and assessment of risks of material misstatement, which comes later in the standard.

Scalability

Background

17. In developing the revisions to ISA 315 (Revised), the IAASB recognized that the auditor’s ability to serve the public interest includes the ability to apply ISA 315 (Revised) to audits of financial statements for all entities, ranging from small, simple, non-complex entities to large, complex, multinational entities.
18. The IAASB believes that although size of the entity is relevant, the level of complexity in the nature of an entity and its financial reporting also drives scalability in the application of the standards (including ED-315). Many smaller entities have complexities in their business model and their financial reporting processes. Therefore, auditors may need to perform more robust or detailed risk assessments for those entities.
19. In ED-315, the proposed application material included considerations for audits of entities that are both *smaller and less complex*, which are those audits that would typically require simpler risk assessment procedures. However, in some cases these considerations were contrasted with considerations for audits of larger, complex entities (e.g., in relation to the understanding of an entity’s use of IT) to help implementation of the standard to entities with different sizes and complexities. This approach was intended to demonstrate scalability for both more and less complex entities, in relation to the nature, timing and extent of the auditor’s risk assessment procedures. The IAASB also considered the placement of the guidance related to scalability. In many cases, this guidance relating to audits of smaller and less complex entities were placed at the start of the relevant application material sections, so that auditors of such entities would be able to more appropriately consider the material that followed in context.

¹⁷ Summary of comments received from exposure for this section are detailed under the section “Understandability, Complexity and Length of the Standard” above.

20. In making the proposed revisions with regard to scalability, the IAASB removed the “considerations specific to smaller entities” sections throughout ED-315. However, most of the matters previously included in these sections were retained and built into the text of ED-315 as appropriate, together with further proposed revisions to illustrate scalability. In some cases, it was found that the content of the extant “considerations specific to smaller entities” sections was not unique to audits of smaller and less complex entities, and this guidance was built into the application material more generally.

Summary of Comments Received on Exposure

21. Although respondents supported some of the aspects of scalability in ED-315, such as the recognition of less formal policies and procedures in smaller and less complex entities, ongoing significant concerns were expressed about the scalability and proportionality overall of the proposed revised requirements.
22. The IAASB was encouraged to further consider scalability, so that the changes were not seen to be unduly onerous in an audit of a less complex entity and therefore inhibit implementation. This included giving consideration to how the scalability guidance is presented and to which entities it applies, with a call for separate paragraphs to highlight these considerations.

IAASB Decisions

23. In addition to the efforts on making improvements with regard to understandability and complexity, as discussed in paragraph 12 of this document (some of which would also apply to scalability), the IAASB agreed to:
- Present separate scalability paragraphs under a heading entitled “scalability,” to highlight and illustrate the proportionality and scalability of the standard (for example, paragraphs A16–A17, A33, A44–A45 etc.).
 - Where appropriate, illustrate the scalability through providing contrasting examples (i.e., illustrating both sides of the complexity spectrum) (for example, below paragraph A17).
 - Refer to ‘less complex entities’ rather than ‘*smaller and* less complex entities’ to be consistent with the IAASB’s other projects where it has been recognized that the challenges of applying the ISAs relate more to complexity than the size of an entity.

Modernizing and Updating the ISA for an Evolving Business Environment, Including Information Technology (IT)

Background

24. ED-315 proposed changes to address:
- 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.
 - Recent and ongoing developments relating to internal control¹⁸ and other relevant frameworks.

¹⁸ For example, the IAASB considered changes that had been made to the Committee of Sponsoring Organizations (COSO) Internal Control – Integrated Framework 2013 (COSO Integrated Framework – 2013)

- Continuing evolution of entities' use of IT, in particular to enhance the auditor's required understanding of the entity's use of IT in its business, and within the system of internal control.
25. The IAASB proposed significant clarifications and enhancements to the requirements in ED-315 such that the auditor is required to understand the entity's use of IT in its business and system of internal control. This understanding forms the basis for the auditor's identification of risks of material misstatement arising from the entity's use of IT, and the identification of any relevant general IT controls that the entity has put in place to address those risks of material misstatement. The application material has been significantly enhanced to appropriately support the proposed enhanced requirements. However, in making these proposed revisions, the IAASB has been mindful to introduce additional material relating to IT in a principles-based manner, recognizing that rapid changes in IT and the terms in which it is described could 'date' the standard within a short space of time.
26. The IAASB has further considered whether more needed to be enhanced in ED-315 in relation to the auditor's consideration of the risks of fraud. On balance, the IAASB believed that there are sufficient references within ED-315 to ISA 240, but highlighted in the introductory paragraphs the need to also apply ISA 240 when identifying and assessing the risks of material misstatement due to fraud.

Summary of Comments Received on Exposure

27. Respondents to ED-315 welcomed the changes made to update and enhance the application material in relation to the entity's IT, and broadly supported many of the changes proposed in ED-315. However, in addition to specific matters relating to the definitions and other enhancements made, there were various calls for more guidance, including in relation to outsourcing, cybersecurity, how risks arising from IT are identified, and with regard to IT general controls. In addition, there were calls for more defined terms relating to IT and more guidance relating to applying the requirements in less complex environments. It was also highlighted that some of the material that had been added was too detailed for the standard.

IAASB Decisions

28. To assist with a consistent understanding of the concepts underlying the application material related to IT, various changes were made to the IT-related definitions:
- The IAASB acknowledged concerns about the scope of application controls and changed the term to 'information processing controls' (with corresponding changes as appropriate) (see paragraph 12(e)). Although aspects of the definition of 'application controls' have been maintained, the proposed definition draws on the COSO definition of transaction controls and therefore also specifically acknowledges that such controls may be automated or manual. The term "information processing controls" has been used instead of "transaction controls" to appropriately reflect the control activities related to the information system, which are not limited to control activities related to the flows of transactions. The definition was also simplified to focus on the role of these controls in addressing risks to the integrity of information in the information system.
 - The IAASB has added a definition for *risks arising from the use of IT* to drive consistency in application. This definition explains the concept in the context of risks to the effective design and operation of information processing controls (see paragraph 12(i)).

- The IAASB clarified the definition of general IT controls to explain that these are controls over the entity's IT processes.
29. Clearer delineation has been made in the application material between the respective work efforts for understanding the IT environment as part of the understanding of the information system (paragraphs A140 to A143) and the requirements to identify and address risks arising from the use of IT related to the IT applications and other aspects of the IT environment. The application material has also been re-ordered to follow the flow of the revised requirements (paragraphs A166–A172).
30. Consistent with the overall approach to streamlining the application material, the application material to the IT-related requirements has been streamlined to focus on the understanding required and decisions to be made by the auditor with respect to identifying and addressing risks arising from the use of IT. Guidance that includes details about an entity's IT environment and the varying complexities thereof, as well as detailed guidance about the effects of these specific characteristics on the audit have been relocated to a new IT Appendix. Recognition of matters raised by respondents, such as cybersecurity, have also been included (see Appendix 5).
31. A new Appendix (appendix 6) was also added to provide the auditor with considerations for understanding general IT controls.

Automated Tools and Techniques

Background

32. The increasing use of automated tools and techniques by auditors when performing risk assessment procedures necessitated changes within ED-315 to recognize the usage of such tools and techniques explicitly. The IAASB also sought a balanced perspective, because automated tools and techniques may not be available to all auditors at the present time, or may not be necessary or appropriate in the circumstances.
33. In developing the proposals, the IAASB concluded that the focus of ED-315 should be on gathering sufficient appropriate audit evidence, and not on being prescriptive or limiting in terms of *how* audit evidence is obtained. Accordingly, the IAASB's Technology Working Group (previously the Data Analytics Working Group) assisted in developing application material to provide examples of how automated tools and techniques are being used in the risk assessment process.
34. In developing this application material, the IAASB was mindful about how these tools and techniques have been described. Although the term 'data analytics' is sometimes used to refer to such tools and techniques, the term does not have a uniform definition or description. The IAASB is of the view that the term 'data analytics' is potentially too narrow because it may not encompass all of the emerging technologies that are being used when performing risk assessment or other audit procedures today and the technologies and related audit applications that will continue to evolve in the future, such as artificial intelligence applications, robotics automation processes and the use of drones. The IAASB therefore decided to use the broader term *automated tools and techniques* in ED-315.

Summary of Comments Received in Exposure

35. Respondents broadly supported the approach to the enhanced and focused application material relating to the auditor's use of automated tools and techniques. However, there were respondents who called for:
- More prominence of automated tools and techniques within the standard.

- A new requirement related to automated tools and techniques.
 - More guidance relating to the use of automated tools and techniques during the risk assessment process, in particular relating to documentation.
 - More guidance when a procedure performed using an automated tool or technique is used as a risk assessment procedure and a further audit procedure.
 - A definition of automated tools and techniques.
36. It was also emphasized that the use of automated tools and techniques is a judgment by the auditor, and the requirements set by the IAASB should be neutral with regard to the types of tools used (i.e., to not explicitly name a tool so as to suggest that is the most appropriate tool for that type of procedure) because many smaller firms do not necessarily have access to these tools.

IAASB Decisions

37. The IAASB continues to have the view that using automated tools and techniques is the way that a procedure is carried out, and the Board cannot mandate their use (also taking into account that not all practitioners will have access to such tools). No significant further changes have been made to the content of the paragraphs addressing 'automated tools and techniques,' except for placing them under a dedicated heading.
38. As part of the 'implementation' package, the IAASB will also publish a non-authoritative guide with questions and answers relating to the use of automated tools and techniques in the risk assessment process, but which are not only relevant to the risk assessment process. The Technology Working Group will also continue to develop non-authoritative guidance relating to the use of automated tools and techniques for the extant ISAs, some of which may include matters that are relevant to risk identification and assessment.

Professional Skepticism

Background

39. The IAASB recognizes that professional skepticism plays a central role in any audit and ED-315 contained several key provisions designed to enhance the auditor's exercise of professional skepticism throughout the risk assessment process, including in ED-315:
- Emphasizing in the introductory paragraphs the importance of applying professional skepticism.
 - Clarifying that a thorough and robust understanding of the entity and its environment, and the applicable financial reporting framework, provides a foundation for being able to exercise professional skepticism throughout the rest of the audit.
 - Highlighting the benefits of applying professional skepticism during the required engagement team discussion.
 - Highlighting that contradictory evidence may be obtained as part of the auditor's risk assessment procedures.
40. The IAASB also used more explicit language and enhanced application material to reinforce the importance of applying professional skepticism as appropriate.

Summary of Comments Received on Exposure

41. Overall, respondents supported the proposals related to enhancing the application of professional skepticism throughout the risk identification process. However, there were further calls for enhancements to the application material and more explicit requirements related to professional skepticism during the risk assessment process.

IAASB Decisions

42. The IAASB agreed to two new requirements to further emphasize the importance of professional skepticism during the risk assessment process:
- A new paragraph was added to the overall requirement for the auditor to perform risk assessment procedures to obtain evidence to provide an appropriate basis for the identification and assessment of the risks of material misstatement, and designing further audit procedures, emphasizing the need to not bias the auditor's work toward obtaining evidence that is corroborative or excluding evidence that is contradictory (paragraph 13).
 - A new requirement has been added for the auditor, towards the end of the risk assessment process, to consider all audit evidence obtained from performing risk assessment procedures, whether corroborative or contradictory, (paragraph 35) to evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement.
 - Application material has been added to support the new requirements, in particular to encourage the auditor to remain alert to the existence of risks when undertaking risk assessment procedures (paragraphs A14 and AA230–A232).

Risk Assessment Procedures and Related Activities

Background

43. ED-315 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. This makes it clear that performing risk assessment procedures provides audit evidence. It was noted in developing ED-315 that linking the risk assessment procedures performed to sufficient appropriate audit evidence emphasizes the need for professional skepticism in obtaining and evaluating this audit evidence as the basis for the identification and assessment of the risks of material misstatement.

Summary of Comments Received on Exposure

44. Concern was expressed by respondents about using the term “sufficient appropriate audit evidence” as the purpose or objective of risk assessment procedures, as doing so may cause confusion with how the term is used with regard to the relevance and reliability of audit evidence needed to support the audit opinion. In addition, it was noted that this may cause unnecessary work where efforts could be focused elsewhere.

IAASB Decisions

45. The revised requirement was intended to require a work effort that is commensurate with the purpose of performing risk assessment procedures. Accordingly, the IAASB has clarified that the purpose of

performing risk assessment procedures is to obtain audit evidence that provides an appropriate basis for the identification and assessment of the risks of material misstatement, but also for the design of further audit procedures in accordance with ISA 330 (paragraph 13).

Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework

Background

46. In ED-315, the IAASB restructured the requirement that focuses on the auditor's understanding of the entity and its environment. The IAASB elevated the importance of the auditor's required understanding of the applicable financial reporting framework, because it is the application of the framework in the context of the nature and circumstances of the entity that gives rise to potential risks of misstatement. This revision was intended to clarify the context of understanding the framework, and included enhancements requiring the auditor to focus on the reasons for changes to the entity's accounting policies.
47. ED-315 introduced a new concept of 'inherent risk factors' to address the auditor's contemplation of factors that could give rise to potential risks arising from their understanding of the entity and its environment, and the application of the applicable financial reporting framework. The inherent risk factors are intended to assist the auditor in identifying events or conditions, the characteristics of which may affect the susceptibility of assertions about classes of transactions, account balances or disclosures to misstatement.

Summary of Comments Received on Exposure

48. The respondents to ED-315 were broadly supportive of the changes that had been proposed.

IAASB Decisions

49. Changes made related to the auditor's understanding of the entity and its environment, and applicable financial reporting framework, arose mainly from the broader overall changes to ED-315, and included:
 - Maintaining a separate requirement to evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework from the requirement to obtain an understanding of the applicable financial reporting framework (paragraph 20), which is now consistent with the requirements to understand and evaluate the components of the entity's system of internal control (see section that follows, below).
 - Rearticulating how the inherent risk factors are used as the auditor considers possible areas of misstatement when understanding the entity and its environment, and the applicable financial reporting framework. The relevant application material has been enhanced to further explain this (paragraph 19(c)).

Obtaining an Understanding of the Entity's System of Internal Control

Background

50. The auditor's understanding of the system of internal control is consistently an area within ISA 315 (Revised) where challenges and issues have been identified. In ED-315, numerous changes were made to the requirements and application material related to the auditor's understanding of the system of internal control:

- Terms used to describe the various aspects of the entity's system of internal control were revised for clarity and consistency.
- 'Controls' were defined as the policies and procedures embedded within the components of the system of internal control, and recognition given to controls that may be less formalized (i.e., not formally documented policies or procedures) to recognize controls that may be operating in less complex environments.
- The term 'control activities' was used to describe one of the components of the system of internal control.
- Changes to each of the components of the system of internal control were made to be clear about the work effort necessary in obtaining the required understanding of that component. More detail was also provided about the matters the auditor would need to understand in each component. In particular, further clarity was provided about the auditor's understanding of the information system, and how it was different from the understanding of the controls in the control activities component. In addition, specificity about which controls should be identified in the control activities component was added, and ED-315 further clarified the evaluation of the design, and determination of whether the control had been implemented (D&I), for these identified controls.
- The order of the components of the system of internal control were changed to 'group' the components that were similar in nature (i.e., components that consist primarily of 'indirect controls' were presented first before the two components that consist primarily of 'direct controls').
- It was clarified that the auditor's understanding of the entity's system of internal control informs the auditor's expectations about the operating effectiveness of controls and the auditor's intentions to test controls in designing and performing further audit procedures, and is therefore the foundation for the auditor's assessment of control risk.
- ED-315 extended the requirement to identify deficiencies in controls based on the auditor's evaluations of all components of the system of internal control.

Summary of Comments Received on Exposure

51. Support was expressed by respondents to ED-315 for:

- The distinction between 'direct' and 'indirect' components of internal control.
- The delineation between 'understanding the components of internal control' and 'identifying controls relevant to the audit and evaluating the design of such controls.' However, the latter was seen to suggest that the D&I was required for all components of internal control.

52. While welcoming more clarity about what was needed to be understood, there were concerns about the changes providing specificity within the requirements to help the auditor understand "what" is needed to be understood for each component of internal control. There were respondents who welcomed the enhancements, while others (in particular those representing SMP / SME stakeholders) saw these changes as adding additional prescription and complexity, and therefore urged the IAASB to revert to more principles-based standards. It was also noted that the purpose of obtaining the required understanding of the components of the system of internal control was still not clear, in particular if the auditor did not intend to test the operating effectiveness of controls.

53. It was highlighted that:

- Further clarification was needed as to what was needed to be done with regard to the ‘evaluations’ for each of the components (it was also noted that these were not consistently required).
- The scope of the auditor’s work was still not clear, in particular in relation to the information system component (e.g., the scope of the work relating to the term ‘relevant to financial reporting’).
- Various inconsistencies in the use of terms related to internal control and controls were still prevalent.
- The new requirement to judgmentally identify other controls in the control activities component for which the auditor would evaluate their design and implementation was too broad as it was not clear what the intention of the requirement was.

IAASB Decisions

54. In addition to the changes and enhancements to address understandability, length and complexity within the requirements and related application material relating to the auditor’s understanding of the system of internal control (as explained above), the IAASB presented the required understanding for each component of the system of internal control in tabular format (paragraphs 21, 22, 24, 25 and 26). The intention of the table is to help with understandability of the requirements related to each component of the system of internal control (i.e., to make clear that the required understanding consists of both understanding the matters set out in the requirement and the evaluation of those matters in the context of the nature and circumstances of the entity). However, the table may also be read sequentially, which would not change the substance of the requirement.

55. Changes have also been made to:

- Address the perceived prescriptiveness of the requirements where appropriate.
- Ensure the presentation of each of the components is consistent. As a result, an additional ‘evaluation’ has been added where there was none previously (e.g., for the entity’s process for monitoring the system of internal control (paragraph 24(c))).
- Further clarify for which controls D&I is required (i.e., only those controls identified within the control activities component) (paragraph 26(d)).
- Combine the various requirements to determine whether control deficiencies exist within the components of the entity’s system of internal control (paragraph 27) to avoid repetition of the same requirement for each component. In addition, the IAASB is of the view that ISA 315 (Revised 2019) does not need to repeat the requirement to determine whether the deficiencies are a significant deficiency because this requirement already exists in ISA 265¹⁹ (and this requirement is already referenced within the application material).
- Better reflect the interrelationship of the concepts of the IT environment, risks arising from the use of IT, and general IT controls, by merging and streamlining the related requirements (paragraphs 26(b) and (c)).

56. The controls required to be understood in the control activities component have been reordered from those that are less subjective to those that are more subjective (paragraph 26). The requirement to identify

¹⁹ ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 8

'controls in the auditor's judgment' has also been revised to clarify that these relate to other controls that the auditor considers it appropriate to obtain an understanding of to enable the auditor to meet the objectives in paragraph 13 of the standard, with respect to risks at the assertion level, and are based on the auditor's professional judgment (paragraph 26(a)(iv)). Application material has been added to further clarify the intent of the requirement by providing examples of what these controls may be (paragraph A165).

57. The IAASB enhanced the explanations or added a 'why' section to address the rationale for the understanding of the components of the entity's system of internal control. Broadly, this has been done through explaining the 'why' in respect of the understanding of the indirect and the direct components separately, and where applicable, for individual aspects within this section. The enhancement of the "why's" are intended to help auditors understand why an understanding of each component of internal control is required (particularly in circumstances where it is intended that a primarily substantive approach to the audit will be undertaken).
58. It has been clarified in the application material that the nature and extent of work required is determined by the auditor taking into account the nature of the component, as well as the nature and circumstances of the entity (see paragraph A16).

Identifying and Assessing the Risks of Material Misstatement

Background

59. The audit risk model was not intended to be revised. Rather, the changes made in ED-315 to address the issues that had been identified were intended to clarify and assist auditors in identifying and assessing risks of material misstatement in a more consistent and robust manner.
60. To assist with the robustness and consistency of the identification and assessment of risks of material misstatement, the IAASB had the view that a more explicit and systematic risk identification and assessment process would help drive a more consistent and focused approach. To facilitate this, the IAASB introduced new concepts and definitions, and significantly enhanced the related requirements and application material:
 - *Inherent risk factors*²⁰—a new definition explaining that these are characteristics that affect susceptibility to misstatement of an assertion about a class of transactions, account balance or disclosure, and that may be quantitative or qualitative in nature, including *complexity, subjectivity, change, uncertainty and susceptibility to misstatement due to management bias or fraud*. The intention of introducing the inherent risk factors was to assist the auditor in focusing on those aspects of events or conditions that affect an assertion's susceptibility to misstatement, which in turn facilitates a more focused identification of risks of material misstatement. Taking into account the degree to which the inherent risk factors affect susceptibility to misstatement is also intended to assist in the assessment of inherent risk.
 - *Relevant assertion*—a new definition was introduced to focus auditors on those assertions relevant to a class of transactions, account balance or disclosure when the nature or

²⁰ The concept of inherent risk factors was also included in ISA 540 (Revised), which was finalized at the same time as ED-315. A supplement to ED-315 was issued to explain the interaction of ED-315 and ISA 540 (Revised), and the conforming amendments to ISA 540 (Revised) arising from ED-315. As the changes to ED-315 have been progressed, further conforming changes have been made to ISA 540 (Revised) as necessary to reflect the further changes.

circumstances are such that there is a reasonable possibility²¹ of occurrence of misstatement with respect to an assertion, that is material, either individually or in combination with other misstatements. Application material to the definition explained that there will be one or more risks of material misstatement that relate to a relevant assertion. The introduction of the concept of 'relevant assertion' was viewed by the IAASB to have the benefit of enhancing the completeness of the auditor's identification of the risks of material misstatement by requiring the auditor to identify those assertions where risks of material misstatement exist (i.e., are reasonably possible) and therefore need to be identified.

- *Significant class of transactions, account balance or disclosure*—a new definition was introduced to address a class of transactions, account balance or disclosure for which there is one or more relevant assertions. The introduction of the concept of a significant class of transactions, account balance, or disclosure was viewed by the IAASB to have the benefit of clarifying the scope of the auditor's understanding of the information system,²² as well as the scope of the auditor's responses to the assessed risks of material misstatement,²³ and the related requirements in ISA 540 (Revised) that address these topics.²⁴
- *Spectrum of inherent risk*²⁵—a concept explicitly included in the introductory paragraphs and application material recognizing that inherent risk factors individually or in combination increase inherent risk to varying degrees, and that inherent risk will be higher for some assertions than for others. Although not defined, it was explained that the degree to which inherent risk varies is referred to as the spectrum of inherent risk, and the relative degrees of the likelihood and magnitude of a possible misstatement determine where on the spectrum of inherent risk the risk of misstatement is assessed. The IAASB is of the view that the introduction of the spectrum of inherent risk would 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.

61. In its deliberations about the concept of significant risk, and being mindful of the issues and challenges related to the identification of significant risks, the IAASB had the view that it was important to retain the concept, in particular because of the focused work effort in other ISAs on these types of risks. However, to address the issues and challenges that had been identified the IAASB revised the definition of significant risk:

- To promote a more consistent approach to determining significant risks, the proposed revision focused not on the response to the risk, but on those risks for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk. This update to the definition incorporated the extant requirement for significant risks to be determined excluding the effects

²¹ In its deliberations, the IAASB had the view that it was important to explain the level of likelihood that should be taken into account when identifying relevant assertions and risks of material misstatement. With respect to ED-315, the IAASB selected 'reasonably possible' (also with recognition that this term is used in the US Public Company Accounting Oversight Board (PCAOB) standards in a similar context). The definition explained that 'reasonably possibly' equates to 'more than remote.'

²² ED-315, paragraph 35(a)

²³ ISA 330, paragraph 7 (see conforming amendment)

²⁴ Conforming amendments have been made to ISA 540 (Revised).

²⁵ The concept of inherent risk factors was included in ISA 540 (Revised) with conforming amendments made as appropriate.

of identified controls related to the risks (i.e., based on inherent risk alone). Further, by defining the significant risks as “close to the upper end” of the spectrum, it suggested there may be one or more risks that could be determined to be ‘significant risks.’

- In revising the definition of significant risk, the IAASB also deliberated whether these risks are represented on the spectrum of inherent risk by both a high likelihood of occurrence ‘*and*’ a high magnitude of potential misstatement should the risk occur, or whether a significant risk could also be present when there is a high magnitude of potential misstatement but a low expectation of the risk occurring. On balance, the IAASB agreed that there could be risks potentially low in likelihood, but for which the magnitude could be very high if it occurred, and that it was probably not appropriate to explicitly exclude these risks from the auditor’s determination of significant risks. The definition therefore acknowledges that a significant risk could result from the degree of likelihood of misstatement ‘*or*’ magnitude of potential misstatement.
62. ED-315 proposed requirements for the separate assessment of inherent risk and control risk,²⁶ taking into account the requirements in ISA 330, paragraph 7, that require the auditor to consider inherent risk and control risk separately in order to respond appropriately to assessed risks of material misstatement. The IAASB agreed to maintain this separate assessment of inherent risk and control risk as this was strongly supported by respondents to ED-315.²⁷
63. The IAASB has also made a stronger link to the work performed on the D&I of controls relevant to the audit, with enhanced application material to further explain how the D&I work interacts with the auditor’s assessment of control risk. The IAASB made it clear that if the auditor does not contemplate testing the operating effectiveness of controls, or is not required to test controls, control risk is assessed at maximum (i.e., control risk cannot be reduced for the effective operation of controls unless the auditor intends to test them). In the view of the IAASB this would allow auditors who intend to perform a primarily substantive audit to not have to do anything further in relation to controls (i.e., in addition to the required understanding of each of the components of internal control).
64. The IAASB introduced a stand-back requirement in ED-315:
- Intended to drive the completeness of the identification of the risks of material misstatement by evaluating the completeness of the significant classes of transactions, account balances and disclosures identified by the auditor..
 - Focused on material classes of transactions, account balances or disclosures that have not been determined to be significant (i.e., the auditor has not identified any risks of material misstatement that are reasonably possible and therefore there are no relevant assertions).
 - The description of ‘material’ was expanded to be ‘quantitatively or qualitatively material’ with supporting application material to describe its meaning in this context. After identifying the classes of transactions, account balances and disclosures that are quantitatively or qualitatively material, the new requirement required the auditor to reconsider, for such classes of transactions, account balances or disclosures, whether there could be one or more risks of material misstatement at the assertion level.

²⁶ See paragraph 53 of the Explanatory Memorandum to ED-315.

²⁷ This change was initially made in the project to revise ISA 540, with conforming amendments made as necessary to conform with this revised ISA 315 (Revised 2019).

65. Paragraph 18 of ISA 330 is also targeted at 'material' classes of transactions, account balances and disclosures,²⁸ and requires substantive procedures to be performed for all such classes of transactions, account balances and disclosures. The IAASB agreed to further consider the interaction of paragraph 18 of ISA 330 with the revisions proposed to extant ISA 315 (Revised) despite these paragraphs serving a similar purpose to safeguard against imperfect risk identification and assessment. The IAASB had mixed views and therefore maintained the paragraph (looking for stakeholder views in ED 315), with changes made to:
- Clarify that ISA 330 paragraph 18 applies 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,
 - Explain, in the application material, the interaction of the requirement with the new concept of significant classes of transactions, account balances and disclosures.
 - Clarify the work effort in respect of classes of transactions, account balances or disclosures caught by this requirement.

Summary of Comments Received on Exposure

66. With regard to the changes proposed in ED-315, respondents generally supported:
- The separation of the assessment of inherent risk and control risk, and the clarifications made. Notwithstanding the support, various concerns were expressed in relation to how the auditor considers the interaction of inherent and control risk in order to assess the risks of material misstatement.
 - The explicit introduction of the concept of the spectrum of risk, but encouraged that more guidance be added to explain how this is operationalized within the standard. There was also a suggestion that a requirement be added to assess where each risk belongs in the spectrum of risks, with appropriate documentation of this assessment.
 - The new definitions for relevant assertions and significant classes of transactions, account balances and disclosures, but there were strong views expressed about the 'threshold' for the reasonable possibility of the occurrence of a misstatement. In particular, stakeholders were of the view that 'reasonable possibility' of a misstatement did not equate to the possible misstatement being 'more than remote.' In addition, concerns were also expressed about the complexity of the definition of relevant assertion.
 - The introduction of the concept of inherent risk factors. However, there were mixed views about how fraud was captured in inherent risk factors, as fraud risks factors can be identified from conditions that relate to control risk as well as inherent risk.
67. Respondents supported the direction of change with regard to the definition of significant risk (i.e., to emphasize it is not about the responses that drives the determination but rather where on the spectrum of inherent risk the identified risk lies). However, there were concerns about:
- The use of the term 'close to the upper end' to explain where these risks lie on the spectrum of inherent risk.

²⁸ "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."

- The aspect of the definition that requires the auditor to consider likelihood ‘or’ magnitude, and recommend that the ‘or’ is replaced with an ‘and.’ Respondents expressed concern that the ‘or’ may cause different interpretations and have unintended consequences, such as an unrealistic increase in the number of significant risks identified, in particular where the likelihood of occurrence of misstatement is low.
68. There were mixed views in relation to support for the new stand-back, retaining paragraph 18 of ISA 330, or whether both were needed. There were also mixed views in relation to the description of material as being ‘quantitative’ and ‘qualitative’ in the stand-back. Those respondents who supported the additional wording argued that it is a helpful reminder that materiality includes both quantitative and qualitative aspects, while others thought it was unnecessary and implicit in the definition of materiality.

IAASB Decisions

69. In addition to the changes and enhancements to address understandability, length and complexity, as discussed in paragraph 12 of this document, within the requirements and related application material relating to the auditor’s identification and assessment of the risks of material misstatement, the IAASB:
- Enhanced the application material with regard to the spectrum of inherent risk to further explain how it should be operationalized, and to provide further context for the use of ‘close to the upper end’ when referring to a significant risk (paragraphs A208–A214). The IAASB did not enhance the requirements in relation to spectrum of inherent risk and how risks should be assessed on that spectrum in order to maintain a principles-based standard. The way firms assess risks along the spectrum varies, and therefore the standard could not prescribe how this concept is to be operationalized.
 - Simplified the definition of relevant assertion (paragraph 12(h)), and rearticulated the requirement to determine significant classes of transactions, account balances and disclosures, and their relevant assertions, to be consistent with how they are defined (paragraph 29). In simplifying the definition of relevant assertion, the IAASB agreed that ISA 315 (Revised 2019) should not be the place where the ‘threshold’ for the identification of a possible misstatement be explained, and moved the explanation of this ‘threshold’ to support the definition of risk of material misstatement in ISA 200²⁹ (with the intention to better link this threshold with the ‘acceptably low level’ explained in ISA 200). In addition, references to ‘more than remote’ have been removed. Accordingly, as the term ‘reasonably possible’ is used within ISA 315 (Revised 2019), its meaning is supported and explained in the application material to ISA 200 (i.e., that a risk of material misstatement exists where there is a reasonable possibility of both a misstatement occurring (i.e., its likelihood), and being material if it were to occur (i.e., its magnitude))(paragraph A13a of ISA 200 in the Conforming Amendments).³⁰
 - Revised the definition of inherent risk factors as it related to including “susceptibility to misstatement due to management bias or *fraud*”. To alleviate concerns that the reference to fraud in the inherent risk factors went beyond its impact on inherent risk , the IAASB rearticulated the inherent risk factor to include ‘susceptibility to misstatement due to

²⁹ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

³⁰ The change has been made as a conforming amendment to ISA 200.

management bias or other *fraud risk factors insofar as they affect inherent risk*' (paragraph 12(f)) to recognize that the fraud risk factors to be considered are those that affect inherent risk rather than control risk (which are addressed in ISA 240).

- Recognized the issues related to the use of “risk of material misstatement” and specifically considered the suggested change to identify “inherent risks” instead of “risks of material misstatement.” Notwithstanding that the definition of a risk of material misstatement includes both inherent risk and control risk, in the view of the IAASB, changing such a term may raise questions regarding the lack of a requirement to identify “control risks” (the standard requires the auditor to assess control risk). It may also further the misconception that the identification of risks of material misstatement can be performed effectively without understanding the entity’s system of internal control. Nonetheless, changes were made to clarify that the identification of the risk of material misstatement is ‘based on inherent risk (see paragraph A186)’
- Changed the definition of significant risk from considering the “likelihood ‘or’ magnitude” to considering “likelihood ‘and’ magnitude” (paragraph 12(l)), but enhanced the application material to emphasize that the determination of a significant risk also takes into account the combination of the likelihood and magnitude as well as the relative effects of the inherent risk factors, and how those influence where on the spectrum of inherent risk a risk lies.
- Rearticulated the requirement to assess control risk to explain more directly how control risk is assessed when the auditor does not plan to test the operating effectiveness of controls (paragraph 34). This change better facilitates the statements made in ISA 200 and ISA 540 (Revised) that the auditor separately assesses inherent risk and control risk, but it also makes clear that the assessment of control risk would only change the auditor’s assessment of the risk of material misstatement if the auditor plans to test the operating effectiveness of controls. An explanation within the first- time implementation guidance (in development to support the application of the changes to ISA 315 (Revised 2019) will further highlight that if there is no intent or requirement to test the operating effectiveness of controls, and the auditor chooses not to test the operating effectiveness of controls, that this decision or course of action in itself represents an ‘implicit’ assessment of control risk.
- Retained both ISA 330 paragraph 18 and the stand-back in ISA 315 (Revised 2019) as respondents to the specific question in ED-315 regarding retaining one, or both, paragraphs, did not provide a strong preference on balance (i.e., there was no compelling reason to make changes to what had been exposed). However, the IAASB did remove ‘*quantitatively and qualitatively*’ (material) from the requirements as this was already implicit in the description of material in terms of ISA 320.³¹ The IAASB also revised the stand-back to clarify that it is classes of transactions, account balances and disclosures that are material (not significant as those would already have been addressed) that are subject to further consideration in this paragraph (paragraph 36).
- Further considered whether substantive procedures for *all* relevant assertions, for material classes of transactions, account balances or disclosures, in paragraph 18 of ISA 330 is required, but agreed that no further changes were needed beyond the proposed application material³² that makes it clear that the auditor would consider the most appropriate assertion when designing substantive audit procedures.

³¹ ISA 320, *Materiality in Planning and Performing an Audit*

³² Conforming Amendments made to paragraph A42a of ISA 330

Documentation

Background

70. The IAASB considered expanding the specific documentation requirement in ED-315, but in light of the overall documentation requirements in ISA 230,³³ agreed that it was unnecessary for more detailed documentation requirements to be included in the standard (except as detailed below).
71. Based on the clarifications and enhancements made regarding controls that are relevant in the context of the audit, the IAASB agreed that a more explicit requirement for the documentation of the controls identified to be relevant to the audit would be beneficial. In addition, the IAASB also agreed that it is important to capture the significant judgments made by the auditor in identifying and assessing the risk of material misstatement, including in relation to the determination of significant risks, and has therefore enhanced the documentation requirement in this regard.

Summary of Comments Received on Exposure

72. Respondents expressed mixed views and indicated numerous areas where they considered the documentation requirements in ED-315 needed to be enhanced.

IAASB Decisions

73. The IAASB considered whether other changes were needed to various aspects suggested by respondents but agreed that no further changes would be proposed, taking into account the requirement in ISA 230 to document 'significant matters arising during the audit.'³⁴ However, the IAASB strengthened the documentation requirements for the auditors work in evaluating the design of controls, and determining whether those controls have been implemented, for the controls in the control activities component. This was done to align with the enhancements made in relation to the control activities component (paragraph 38(c)).
74. In progressing changes related to professional skepticism, the IAASB also had the view that enhancing the examples of areas to be documented to demonstrate professional skepticism would be helpful. Accordingly, the IAASB added specific references to paragraphs within ISA 315 (Revised (2019)) that may be documented to help demonstrate the auditor's exercise of professional skepticism (paragraph A238).
75. The IAASB also acknowledges that further guidance may still be needed and plans to consider specific guidance on documentation as the implementation guidance is developed based on feedback received.

Effective Date

Background

76. The Explanatory Memorandum to ED-315 asked respondents whether an appropriate effective date for the standard would be for financial reporting periods ending approximately 18 months after the approval of the final ISA.

³³ ISA 230, *Audit Documentation*, paragraph 8

³⁴ ISA 230, paragraph 8(c)

Summary of Comments Received on Exposure

77. Respondents expressed mixed views on the proposed effective date.
78. Respondents that did not agree with the proposed timeline highlighted that a more realistic timeline is required for such substantial changes, and more time was needed for translation of the revised standard. Some of these respondents noted timelines of 24–30 months would be more realistic. It was also noted by a few respondents who supported the timeline, that their support was on the basis of suggested simplifications to ED-315 and that, if ISA 315 (Revised) were to remain complex, a longer time period should be considered.

IAASB Decisions

79. The IAASB agreed that an effective implementation date of audits of financial statements for periods beginning on or after December 15, 2021 would be appropriate given that:
- The expected final approval from the Public Interest Oversight Board is expected late in 2019, and the date is in line with historical implementation dates coinciding with a calendar year.
 - The approved standard is a foundational standard and firms will need time to update their methodologies and audit tools, develop training materials, and train their staff to reflect the changes made from ISA 315 (Revised). The IAASB noted that a short implementation period may result in a rushed or ineffective implementation, which may have the unintended (and undesired) effect of causing a higher level of negative audit inspection findings.
 - ISA 540 (Revised) is now effective and has introduced revisions to the risk assessment process for accounting estimates related to the revisions made in ED-315. Accordingly, it is expedient to reduce the amount of time between when ISA 540 (Revised) became effective and the proposed revisions to extant ISA 315 have been finalized.
 - Some national auditing standard setters need time to translate the standard and, in some cases, develop supplemental implementation material based on the translated standard.
80. The IAASB agreed that early implementation should be permitted and encouraged given the significant number of inspection findings related to risk identification and assessment.

Conforming and Consequential Amendments

Background and Summary of Comments Received on Exposure

81. The IAASB recently completed a project to revise ISA 540 (Revised),³⁵ another important building block to enhancing audit quality in the public interest. In the process of developing the changes in ED-315, the IAASB recognized the significant interaction between ISA 540 (Revised) and extant (and proposed) ISA 315, because the auditor's risk assessment procedures in relation to accounting estimates build on the principles of, and the procedures required by, ISA 315 (Revised).
82. As part of the 'Exposure Draft package,' changes were proposed to the recently completed ISA 540 (Revised), on which there were very limited comments from respondents (except to the extent that they related to a comment about the underlying change in ISA 315 (Revised)).

³⁵ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, was approved by the Board in June 2018 the Public Interest Oversight Board in September 2018.

83. Conforming amendments were also proposed to ISA 200, ISA 240 and ISA 330. There were also additional conforming amendments, which were more of an editorial nature, that were highlighted and explained, but the specific conforming amendments not presented (because of the more 'editorial' nature of such changes).
84. With the exception of comments in relation to the matters addressed as explained in paragraphs 68 of this document relating to ISA 200, and in paragraphs 65, 68 and 69 of this document relating to paragraph 18 of ISA 330, no significant other matters were raised with respect to the detailed proposed conforming and consequential amendments. However, more broadly respondents noted that:
- ISA 330 should be revised more broadly as a separate project.
 - The conforming amendments should be updated for new revisions made when finalizing the revised standard.
 - The conforming amendments not presented should be presented to the Board when finalizing the standard and its conforming amendments.

IAASB Decisions

85. Further changes have been made in ISA 200 and ISA 330 as explained in paragraph 69.
86. With respect to the other conforming and consequential amendments the IAASB made only minor changes to align with the final text of ISA 315 (Revised 2019).

Post-Implementation Review and Other Activities to Promote Awareness and Understanding and Support Effective Implementation of ISA 315 (Revised 2019)

70. The IAASB intends to undertake a post-implementation review of ISA 315 (Revised 2019) after the second year of implementation (to allow for the changes to the standard to be properly implemented). The objective of this review will be to assess whether ISA 315 (Revised 2019) has achieved its intended objectives, and to assist the IAASB in, among other matters:
- Understanding whether the standard is sufficiently scalable and whether it enhances the exercise of professional skepticism;
 - Identifying implementation challenges and possible areas for improvement within the standard; and
 - Considering whether further enhancements to ISA 315 (Revised 2019) are necessary.
71. The post-implementation review may also identify how practical challenges and concerns are being addressed in practice (by auditors, management and audit committees), and whether further enhancements or refinements to the standard, or additional implementation support, are needed.

Implementation Support Activities

72. The IAASB has committed to perform activities to support awareness, understanding and effective implementation of ISA 315 (Revised 2019). Further information on the implementation activities related to ISA 315 (Revised 2019) will be available on the IAASB's website as it becomes available.

Appendix

PIOB Public Interest Issues Relating to ISA 315

Public Interest Issues	IAASB's Decisions
<p><i>Impact and risk of the use of technology.</i></p> <p>The PIOB encourages the IAASB to address the impact and risk of the use of technology on risk identification and risk assessment (e.g., big data, data analytics, cyber risks and cyber security), and the importance of professional skepticism.</p> <p>The PIOB appreciates the inclusion in the standard of several provisions addressing technology and application material that includes references to automated tools and techniques and gives more emphasis to professional skepticism.</p>	<p>In addition to clarifying the IT-related requirements, application material now focuses on the understanding that is required and decisions to be made by the auditor with respect to identifying and addressing risks arising from the use of IT. Guidance that includes details about an entity's IT environment and the varying complexities thereof, has been enhanced, and in some cases relocated to a new IT Appendix. Recognition of matters raised by respondents, such as cybersecurity, have also been included within this Appendix. A new Appendix was also added to provide further matters for the auditor's consideration when understanding general IT controls.</p> <p>In relation to the changes regarding professional skepticism in ED-315, the IAASB also:</p> <ul style="list-style-type: none"> • Introduced a requirement to design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. • Introducing a requirement to 'stand-back' once the risk assessment procedures have been performed, by taking into account all audit evidence obtained from risk assessment procedures, whether corroborative or contradictory to assertions made by management, to evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement. • Using more explicit language and enhancing application material to reinforce the importance of exercising professional skepticism when performing risk assessment procedures.
<p><i>Requirements and scalability within the standard.</i></p> <p>The separation of the "what" (in the requirements), from the "why" and the "how" (in the application material) in the redrafted ISA 315 generally achieves greater clarity.</p>	<p>In addition to the efforts on making improvements with regard to understandability and complexity (and some of which would also apply to scalability) as explained in paragraph 12 of this Basis for Conclusions, the IAASB agreed to:</p>

<p>The PIOB stresses the importance to include all requirements in the standard. Moreover, the PIOB suggests integrating the concept of scalability in the standard, rather than in the application material.</p> <p>Scalability paragraphs have been separately signposted in the standard, as well as considerations for less complex entities, and placed in the application material, providing illustrative examples of how scalability applies.</p>	<ul style="list-style-type: none">• Present separate scalability paragraphs under a heading entitled “scalability,” to highlight and illustrate the proportionality and scalability of the standard.• Where appropriate, illustrate the scalability through providing contrasting examples (i.e., illustrating both sides of the complexity spectrum).
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