

March 2020

Basis for Conclusions
***ASA 315 Identifying and Assessing the
Risks of Material Misstatement and ASA
2020-1 Amendments to Australian Auditing
Standards***

Prepared by the **Auditing and Assurance Standards Board**

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**Basis for Conclusions ASA 315 *Identifying and Assessing the Risks of Material Misstatement* and
ASA 2020-1 *Amendments to Australian Auditing Standards***

Basis for Conclusions ASA 315 *Identifying and Assessing the Risks of Material Misstatement* and ASA 2020-1 *Amendments to Australian Auditing Standards* has been prepared by the Technical Staff of the Auditing and Assurance Standards Board (AUASB) to provide the background and rationale for the development and approval of the Standard by the AUASB. The Basis for Conclusions relates to, but does not form part of, ASA 315 and ASA 2020-1.

No responsibility is taken for the results of actions or omissions to act on the basis of any information contained in this document or for any errors or omissions in it.

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BASIS FOR CONCLUSIONS

ASA 315 *Identifying and Assessing the Risks of Material Misstatement* and ASA 2020-1 *Amendments to Australian Auditing Standards*

This Basis for Conclusions has been prepared by the Technical Staff of the AUASB to provide the background and rationale for the development and approval of ASA 315 *Identifying and Assessing the Risks of Material Misstatement* and ASA 2020-1 *Amendments to Australian Auditing Standards*, by the AUASB. The Basis of Conclusions relates to, but does not form part of ASA 315 and ASA 2020- 1, and is not a substitute for reading the Standards.

Background

1. In accordance with its mandates under section 227 of the *Australian Securities and Investments Commission Act 2001* and the Financial Reporting Council's *Strategic Direction*, the AUASB's policy is to adopt the International Auditing and Assurance Standards Board (IAASB) ISAs, unless there is a compelling reason not to do so. In addition the AUASB is required to make such amendments to the ISAs to ensure the Australian Auditing Standards both exhibit and conform to the Australian regulatory environment and statutory requirements. Further amendments are made where there are compelling reasons to do so, and are made with a public interest focus.
2. The IAASB issued ISA 315 (Revised 2019) *Identifying and Assessing the Risks of Material Misstatement* and conforming and consequential amendments in December 2019.
3. In 2016 the IAASB commenced a project to update ISA 315 to address feedback from stakeholders including regulators, and findings from the ISA Implementation Monitoring Project. The IAASB had the following objectives in updating ISA 315:
 - To establish 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 its organisation and structure could be modified to promote a more effective risk assessment.
 - To determine what non-authoritative guidance and support tools should be developed thereby aiding its effective implementation, in particular to address concerns by auditors of small to medium sized entities.
4. The IAASB released an exposure draft of proposed ISA 315 in July 2018.
5. In August 2018 the AUASB released the Australian Exposure Drafts¹ of the equivalent IAASB exposure drafts, to gather feedback from Australian stakeholders to inform its submission to the IAASB on proposed ISA 315. The AUASB received comment letters from 7 stakeholders representing private and public sector auditors, professional bodies, and academics. The AUASB also held roundtables in Sydney, Melbourne, Perth, Brisbane, Canberra and Hobart which were attended by over 70 stakeholders representing assurance providers from a range of audit firms, professional accounting bodies, academics, those

¹ Exposure Draft 01/18: *Proposed ASA 315 Identifying and Assessing the Risks of Material Misstatement* (ED 01/18) and Exposure Draft 02/18: *Proposed ASA 2018-1 Amendments to Australian Auditing Standards* (ED 02/18)

charged with governance and preparers of financial statements. The AUASB also held two webinars.

6. Based on the feedback received the AUASB provided a submission² to the IAASB on 2 November 2019. The AUASB's submission included the issues and concerns from Australian stakeholders and the AUASB, that proposed ISA 315 was not understandable, and too complex for consistent and effective interpretation, and that the objective the IAASB established in updating ISA 315 may not be achieved. The AUASB also considered that these issues were potentially compelling reasons for amendment in the Australian standard if they were not addressed appropriately by the IAASB. These issues are detailed in paragraph 10.
7. The AUASB has continued to monitor the development of ISA 315 to ensure that the issues included in our submission have been appropriately addressed, as well as to identify if there are any other concerns with the final ISA 315 with the intention of assessing whether any remaining potential compelling reasons exist. Further details regarding the development of ISA 315 and how the IAASB addressed feedback on their exposure draft can be found in [ISA 315 Basis for Conclusions](#) on the IAASB's website.

Scope

8. This Basis for Conclusions applies to ASA 315 primarily, but is also relevant to ASA 2020-1 which contains the consequential and conforming amendments to:
 - *ASA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*
 - *ASA 210 Agreeing the Terms of Audit Engagements*
 - *ASA 230 Audit Documentation*
 - *ASA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*
 - *ASA 250 Consideration of Laws and Regulations in an Audit of a Financial Report*
 - *ASA 260 Communication with Those Charged with Governance*
 - *ASA 265 Communicating Deficiencies in Internal Control to Those Charged with Governance*
 - *ASA 300 Planning an Audit of a Financial Report*
 - *ASA 320 Materiality in Planning and Performing an Audit*
 - *ASA 330 The Auditor's Responses to Assessed Risks*
 - *ASA 402 Audit Considerations to an Entity Using a Service Organisation*
 - *ASA 500 Audit Evidence*
 - *ASA 501 Audit Evidence – Special Considerations for Inventory and Segment Information*
 - *ASA 505 External Confirmations*

² Refer to [AUASB's full submission](#).

- *ASA 520 Analytical Procedures*
- *ASA 530 Audit Sampling*
- *ASA 540 Auditing Accounting Estimates and Related Disclosures*
- *ASA 550 Related Parties*
- *ASA 570 Going Concern*
- *ASA 600 Special Considerations – Audits of a Group Financial Report*
- *ASA 610 Using the Work of Internal Auditors*
- *ASA 620 Using the Work of an Auditor’s Expert*
- *ASA 700 Forming an Opinion and Reporting on a Financial Report*
- *ASA 701 Communicating Key Audit Matters in the Independent Auditor’s Report*
- *ASA 720 The Auditor’s Responsibilities Relating to Other Information*
- *ASA 800 Special Considerations – Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks*

Major Issues raised by Respondents on Exposure

9. The adoption of international standards and any changes to adopted standards are governed by the AUASB’s policies regarding convergence with IAASB standards and harmonisation with the standards of the New Zealand Auditing and Assurance Standards Board. The policies and procedures incorporate “compelling reasons” tests which must be used to support changes to the international standards (refer paragraph 1).
10. The AUASB received very detailed feedback from respondents on ED 01/18 with the more significant issues included in the submission to the IAASB relating to:
 - the overall length and complexity of the standard;
 - the introduction of many new concepts and definitions, and the actual definitions;
 - order and circularity of the requirements;
 - insufficient detail on the considerations of risk of IT and the use of automated tools and techniques; and
 - that the standard will not be sufficiently scalable to audits of entities across different market segments and industries, in particular audits of small and medium entities.

The AUASB included these issues in its submission to the IAASB.

11. In considering ASA 315 the AUASB determined that the significant issues raised in its submission to the IAASB, as well as those identified through review of subsequent drafts of the standard, have been largely addressed. The AUASB concluded there were no Australian compelling reason amendments to make to the international equivalent version of the standard.
12. Notwithstanding the improvements made, the AUASB believe that ASA 315 is complex in nature, and there are potentially a number of implementation issues which will make the achievement of the objectives of the new standard challenging. The IAASB has committed to providing [tools](#), guidance and developing a webinar to assist practitioners with adoption of

ISA 315. The AUASB will monitor this to consider if further implementation support is required.

13. The IAASB have made extensive changes to ISA 315 since its exposure draft, however determined that the amendments were in response to submissions received, and the fundamental approach and principles on which the standard is based had not changed. Accordingly the IAASB decided by a majority vote that it was not necessary to re-expose the standard.
14. Refer to Appendix 1 which details all major feedback received from Australian stakeholders which were included in the AUASB's submission to the IAASB and how they have been addressed. Further detail on the how the IAASB have addressed comments on their exposure draft is included in the [IAASB's Basis for Conclusion](#).

Conclusion

15. The AUASB voted unanimously to approve and issue ASA 315 on 4 February 2020.
16. The AUASB also considered whether ASA 315 should be re-exposed in Australia. There were several points raised by AUASB members including the volume and significance of changes made to ED 01/18. It was noted that the significant concerns originally raised by Australian respondents were largely addressed, and that there were no known compelling reasons. More than two thirds of AUASB members voted not to re-expose ASA 315.
17. In reaching its conclusions the AUASB considered:
 - all stakeholder feedback;
 - the IAASB's due process and consideration as to whether ISA 315 should be re-exposed.

* * *

Appendix 1

HOW MORE SIGNIFICANT ISSUES RAISED IN THE AUASB SUBMISSION TO THE IAASB HAVE BEEN ADDRESSED

Issue	How addressed
<p><u>Complexity and length of standard</u></p> <ul style="list-style-type: none"> • The increased length of ED 315 is a potential barrier to its understandability and consistent application. • Consider drafting standards for less complex entities, then adding application or guidance for more complex entities. • The introduction of many new definitions and concepts, or the distinction between concepts, add complexity to the standard. • Reassess whether some content currently in the application material of ED 315 should instead be included in other non-authoritative guidance. 	<p>The IAASB has addressed this concern by:</p> <ul style="list-style-type: none"> • Simplifying requirements into what and reducing the number by removing set up or sign post requirements; • Simplifying definitions and concepts; • Restructuring the application material and including why and how to apply the requirements, and • Including more examples in the application material which are in “boxes” to clearly identify them. <p>While overall the standard is still long and complex, the AUASB decided not to make any compelling reason changes to ISA 315.</p> <p>Refer to IAASB’s Basis for Conclusion, paragraphs 12 - 13 for more detail.</p>

Issue	How addressed
<p><u>Definitions</u></p> <p>Significant classes of transactions, account balances and disclosures and relevant assertions. Specifically, the term more than remote in the definition of relevant assertion is fundamentally different to a reasonable possibility, and this revised definition may result in more significant classes of transactions, account balances, or disclosures being identified than was intended.</p>	<p>The IAASB have addressed this concern by:</p> <ul style="list-style-type: none"> • Removing the term more than remote from the definition of relevant assertion which is now: <p>“An assertion about a class of transactions, account balance or disclosure is relevant when it has an identified risk of material misstatement. The determination of whether an assertion is a relevant assertion is made before consideration of controls”</p> • Including a threshold for the identification of a possible Risk of Material Misstatement (ROMM) in ISA 200 (paragraph A3) as follows: <p>“The identification of risks of material misstatement is performed before consideration of any related controls (ie. inherent risk), and is based on the auditor’s preliminary consideration of misstatements that have a reasonable possibility of both occurring, and being material if they were to occur.”</p> • Including a reference from Identifying ROMM (ASA 315 Para 28) to paragraph A186. <p>Refer to IAASB’s Basis for Conclusion paragraph 69.</p>
<p><u>Definition of significant risk and the spectrum of inherent risk</u></p> <ul style="list-style-type: none"> • More detail required on the spectrum of inherent risk i.e. how to assess where on the spectrum a risk resides • Definition of significant risk should be <i>likelihood and magnitude</i> as opposed to the current <i>likelihood or magnitude</i>. • The definition of significant risk should be amended to those <i>at the upper end</i> of the spectrum of inherent risk and not <i>close to the upper end</i> of the spectrum of inherent risk”. 	<p>The IAASB have addressed this concern by:</p> <ul style="list-style-type: none"> • <i>Likelihood or magnitude</i> has been changed to <i>Likelihood and magnitude</i>. • The definition of significant risk has been retained as a risk that the assessment of inherent risk <i>is close to the upper end</i> of the spectrum of inherent risk. However application material has been enhanced (A208-214) to assist with how to operationalise this concept. <p>AUASB considered this and decided not to make any compelling reason changes to ISA 315.</p> <p>Refer to IAASB’s Basis for Conclusion paragraph 69.</p>

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Issue	How addressed
<p><u>Inherent risk factors (IRF)</u></p> <ul style="list-style-type: none"> • Supportive of the concepts and definition. But consider it is overly complicated by having a requirement to explicitly take into account IRF. • Insufficient clarity in how to apply the concepts and definitions of the IRF and the current proposed definition of significant risk. • Inclusion of quantitative is potentially problematic. 	<p>The IAASB have addressed this concern by:</p> <ul style="list-style-type: none"> • Retaining IRFs in requirements however significantly enhancing the related application material including <i>Appendix 2 Understanding the IRF</i> to assist. <p>AUASB considered this and decided not to make any compelling reason changes to ISA 315.</p> <p>Refer to IAASB’s Basis for Conclusion paragraphs 49, 60.</p>
<p><u>Scalability</u></p> <ul style="list-style-type: none"> • Overall concern ED 315 is not scalable to smaller and medium entities. • Terminology used in ED 315 should refer to “less complex entities”. • Recommend guidance and examples be included in the application material of the proposed standard on how to effectively scale the work effort in ED 315 to less complex entities, such as examples of: how to perform risk identification and assessment procedures for a less complex entity where a mainly substantive audit approach will be adopted; and how to perform risk identification and assessment procedures when the entity’s system of internal control may be less detailed and formalised. 	<p>The IAASB have addressed this concern by:</p> <ul style="list-style-type: none"> • Improvements to the overall understandability of the standard. • Including application and other explanatory material with separate “Scalability paragraphs” and where appropriate including contrasting examples (i.e. illustrating both sides of the complexity spectrum). <p>The IAASB are also addressing scalability more holistically in its Low Complex Entity project.</p> <p>Refer IAASB’s Basis for Conclusion paragraph 23.</p>

Issue	How addressed
<p><u>Automated tools and techniques</u></p> <ul style="list-style-type: none"> • Agree with the approach taken of using examples to illustrate how automated tools and techniques may be used in risk assessment. • ED 315 could be further enhanced by addressing: <ul style="list-style-type: none"> ○ How automated tools and techniques may be used for risk assessment, and how they meet or impact the requirements of ED 315. This is to avoid automated tools and techniques being applied in addition to the current requirements. ○ What are the requirements in relation to understanding and/or obtaining evidence over the reliability of underlying data (information produced by the entity) used within automated tools and techniques that are used for risk assessment (including the nature, timing and extent of testing). ○ Risk factors relating to the use of big data and automated analytics technology. 	<p>The IAASB have addressed this concern by:</p> <ul style="list-style-type: none"> • Including dedicated paragraphs on how “automated tools and techniques” may be used. • Implementation guidance to include questions and answers on the use of automated tools and techniques. <p>Refer IAASB’s Basis for Conclusion paragraphs 37-38.</p>
<p><u>Professional scepticism</u></p> <ul style="list-style-type: none"> • Supportive of the principle of obtaining an appropriate base of evidence for risk assessment, however we do not support using the term “sufficient appropriate audit evidence” in a risk assessment process. 	<p>The IAASB have addressed this concern by:</p> <ul style="list-style-type: none"> • Changing the requirement to obtain “evidence to provide an appropriate basis for the identification and assessment of ROMM”. Refer IAASB’s Basis for Conclusion paragraph 42.

Issue	How addressed
<p><u>Internal controls</u></p> <ul style="list-style-type: none"> • It is not sufficiently clear how controls including the understanding obtained over the system of internal control, impact the identification of risks of material misstatement. • Clarify the design and implementation testing required verses gaining an understanding. • More guidance on which controls reside in the Information System and Communication component as distinct from the Control Activities component, and the difference, if any, on the requirements in relation to the audit procedures to be performed on these controls. • Controls relevant to the audit – clarify the intention of 39(e). • Some of our stakeholders have expressed concern that for some less complex entities the controls over journals may not be documented and are difficult to test. 	<p>The IAASB have addressed this concern by:</p> <ul style="list-style-type: none"> • Presented the required understanding and evaluation for each component of the system of internal control in a new tabular format with the intention to help with understandability. • Further clarified the requirements in control activities components including changing 39(e) (paragraph reference in ED 01/18). • Clarified that design and implementation is only required for those controls within the controls activities component. <p>Refer IAASB’s Basis for Conclusion paragraphs 54-58.</p>
<p><u>Information Technology</u></p> <ul style="list-style-type: none"> • Support the introduction of the new IT-related concepts and definitions. • Could be enhanced by including the risk factors relating to current and evolving technology which connect to organizational networks, such as infrastructure / software as a service solutions, wireless networks, blockchain, and other technology devices that connect to organisational networks. 	<p>The IAASB have addressed this concern by:</p> <ul style="list-style-type: none"> • Better reflecting the interrelationship of the concepts of the IT environment, risks arising from the use of IT, and general IT controls. <p>Refer IAASB’s Basis for Conclusion paragraph 55.</p>

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Issue	How addressed
<p><u>Separate inherent and control risk assessment</u></p> <ul style="list-style-type: none"> • Support the separate assessments of inherent and control risk at the assertion level. • Support assessing control risk at maximum if not testing operating effectiveness. • The current use of the singular term (“risks of material misstatement”) both before and after the separate assessment of inherent risk and control risk is confusing. • Provide additional detail on how to assess control risk at various levels of the spectrum of risk. • Describing in greater granularity in ED 315 the process the auditor undertakes to combine their separate inherent and control risk assessments. 	<p>The IAASB have addressed this concern by:</p> <ul style="list-style-type: none"> • Including more detail on how to separately assess inherent and control risk. <p>Refer IAASB’s Basis for Conclusion paragraph 69.</p>
<p><u>Stand-back provision and ISA 330 para 18</u></p> <ul style="list-style-type: none"> • Supportive of a stand-back in 315 but don’t need both, however this was not a significant concern. • Reconsider if the terms “quantitatively and qualitatively” are necessary in ISA 315. 	<p>The IAASB have addressed this concern by:</p> <ul style="list-style-type: none"> • The stand back provision has been retained in both ASA 315 and ASA 330. • The references to qualitative and quantitative in the context of materiality have been removed. <p>Refer IAASB’s Basis for Conclusion paragraph 68-69.</p>