

November 2, 2018

International Auditing and Assurance Standards Board

Re: Proposed International Standard on Auditing 315 (Revised) – Identifying and Assessing the Risks of Material Misstatement and Proposed Consequential and Conforming Amendments to Other ISAs

Thank you for the opportunity to comment on the above Exposure Draft.

MNP LLP (MNP) is one of Canada's largest chartered professional accountancy and business advisory firms. Our clients include a sizable contingent of publicly traded entities, as well as small to mid-size owner-managed businesses, credit unions, co-operatives, First Nations and Indigenous Organizations, not-for-profit organizations, municipalities and government entities. We believe that we are positioned well to provide feedback on this important issue.

Overall, we fully support the IAASB's project to revise ISA 315. We agree that it is important to clarify the existing requirements in the standard to promote consistent application. In addition, we agree that modernizing the standard for changes in a continually evolving environment is necessary.

We have reviewed the Exposure Draft and provide our comments below.

1) *Has ED-315 been appropriately restructured, clarified and modernized in order to promote a more consistent and robust process for the identification and assessment of risks of material misstatement. In particular:*

(a) *Do the proposed changes help with the understandability of the risk identification and assessment process? Are the flowcharts helpful in understanding the flow of the standard (i.e. how the requirements interact and how they are iterative in nature)?*

Yes. Overall, the proposed changes provide clarity of the risk identification and assessment process. We found the flowcharts very helpful in understanding the intended flow of the requirements in ED-315. However, we recommend that ED-315 be revised to provide further clarity on the extent of work required by auditors to evaluate or obtain evidence to support the requirements in 315. At this time, we are unsure whether the standard of evidence or evaluation for ED-315 is the same as that required in ISA 500 *Audit Evidence*.

(b) *Will the revisions promote a more robust process for the identification and assessment of the risks of material misstatement and do they appropriately address the public interest issues outlined in paragraphs 6-28?*

Yes, we think the revisions are likely to result in a more robust identification and assessment of the risks of material misstatement. Overall, we think that the revisions will address the public interest issues. With that said, we've provided our thoughts on a few of the public interest issues in the paragraphs that follow.

For the most part, we think that ED-315 has been sufficiently modernized for an evolving business environment. In today's world it is becoming more and more common for companies to implement fully automated components of their business processes. We therefore recommend expanding the application material that supports paragraph 51. More specifically, we recommend that the standard provide guidance to address the impact on the audit approach when it is determined that the controls relating to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence are not effective (i.e., the controls are not designed or implemented appropriately). We believe that such added guidance would help to improve consistent application of the requirements by auditors dealing with this scenario.

Finally, we think that while ED-315 clarifies significant risks, we are concerned that the concept may continue to be inconsistently applied among auditors. ED-315 states that a significant risk could be represented on the spectrum of inherent risk by either a high likelihood of misstatement or a high magnitude of potential misstatement. However, it does not appear that ED-315 provides examples of when a significant risk results from only one of either a high likelihood of occurrence or a high magnitude of possible misstatement. To promote better understanding and consistency of application, we recommend that examples of various possible significant risk scenarios be added to ED-315.

(c) Are the new introductory paragraphs helpful?

Yes. We found that the new introductory paragraphs provided a clear overview of the standard and the intended flow of understanding and assessing risks of material misstatement.

2) Are the requirements and application material of ED-315 sufficiently scalable, including the ability to apply ED-315 to the audits of entities with a wide range of sizes, complexities and circumstances?

We appreciate the challenges involved in developing a standard that appropriately addresses auditing entities of various sizes. And, for the most part, ED-315 provides sufficient scalability considerations. However, we think that there will be some challenges in applying ED-315 to entities that fit somewhere in between 'smaller, less complex' and 'larger, more complex'. MNP serves a mid-market client base and thus many of our audits are for clients of a size that lies in between the two. In order to comply with the proposed changes to ISA 315, we will need to obtain a more in depth understanding of controls, namely the IT environment. However, in today's economic environment, we think it may be challenging to deliver cost-effective audit services to our mid-market clients that meet all requirements in ED-315.

We "tested" the proposed requirements against a few of our mid-market client audit engagements. Based on this assessment, obtaining the required in-depth understanding of controls and the IT environment did not impact our risk assessment or our overall audit approach. For our mid-market clients, an internal control reliance strategy is often not possible nor efficient. Therefore, the extra documentation of controls had little or no impact on the substantive procedures considered necessary to obtain sufficient, appropriate audit evidence. We have concerns that, for many of these entities, the costs of the auditor obtaining an enhanced understanding of controls and the IT environment may exceed the benefits.

In addition, we are concerned about the amount of judgment that is required in applying the scalability requirements. Size is somewhat relative to the spectrum of clients of each audit firm. That is, what might be considered 'large, more complex' in one firm might be considered 'small, less complex' in another. We believe this is likely to result in inconsistency in application.

- 3) *Do respondents agree with the approach taken to enhancing ED-315 in relation to automated tools and techniques, including data analytics, through the use of examples to illustrate how these are used in an audit (see Appendix 1 for references to the relevant paragraphs in ED-315)? Are there other areas within ED-315 where further guidance is needed in relation to automated tools and techniques, and what is the nature of the necessary guidance?*

We think that ED-315 sufficiently addresses the use of automated tools and techniques. The guidance provided is detailed enough for application; however, it is not so prescriptive that it will limit an auditor's use of automated tools and techniques.

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

In practice, the application of professional skepticism by engagement teams throughout an audit has proven to be difficult. We think that the added robustness of ED-315 will be the real driver behind the exercise of professional skepticism. More specifically, the stand-back requirement will force auditors to take a step back and assess whether the risk assessment results make sense in light of the in-depth understanding of the entity and its environment. In addition, the risk assessment procedures are revised to be more evidence based rather than inquiry alone. As such, we believe that it is the requirements in ED-315 that will result in the exercise of professional skepticism rather than the professional skepticism-specific guidance added to ED-315.

However, we found paragraph 27 of the explanatory memorandum a bit confusing and are concerned that application of the requirements of paragraph 17 of ED-315 may prove to be somewhat challenging. Inherent risks are often identified through consideration of numerous factors, including the risk assessment procedures outlined, and converging into an overall assessment based on the auditor's judgment. We believe practitioners may find it difficult to link the various risks identified to evidence obtained through the performance of the risk assessment procedures.

- 5) *Do the proposals made relating to the auditor's understanding of the entity's system of internal control assist with understanding the nature and extent of the work effort required and the relationship of the work effort to the identification and assessment of the risks of material misstatement? Specifically:*

- (a) *Have the requirements related to the auditor's understanding of each component of the entity's system of internal control been appropriately enhanced and clarified? Is it clear why the understanding is obtained and how this informs the risk identification and assessment process?*

While the requirements are clearer and can be more easily understood, we believe the benefit of obtaining this understanding in the depth that the standard requires may exceed the cost to do so, at least in the short term. Much of our client base (small to medium size businesses) would not necessarily fall into the 'small, less complex' category but would also not be considered 'large, more complex' entities. Further, many of our clients are still exploring options and starting to adopt new technology solutions in their operations. For many of these audits, a combined approach is not often adopted as the control environment is still in a state of flux, and the types of controls usually implemented (e.g., oversight by owner in an owner-managed entity) in these entities generally cannot be used to reduce the amount of substantive work required. We believe that the client may experience significant cost and disruption while the auditor obtains the required enhanced understanding of the system of internal control, without also

experiencing the benefit arising from changes to the auditor's risk assessment and overall audit approach.

ED-315 states that the auditor cannot evaluate the implementation of information system controls relevant to financial reporting and the controls relevant to the audit (including general IT controls) by inquiry alone. We are concerned that the nature and extent of work required to adequately assess these controls may approach that required to perform an IT audit. In our opinion, most financial statement auditors do not have the same knowledge and skills as an experienced IT auditor, and there are not sufficient IT auditors in the marketplace to support the financial statement auditors in completing the required evaluation. We believe that it may be necessary to provide additional guidance on the level of work necessary to appropriately evaluate the implementation of controls.

Furthermore, it is our interpretation that ED-315 requires the auditor to obtain corroborating evidence to support the auditor's inquiry/understanding of the information system controls. However, we think this level of work effort is perhaps beyond what would be necessary to evaluate the design and implementation of controls when the auditor does not intend to rely on those controls based on their understanding of the systems. We believe additional guidance clarifying the work effort involved would be beneficial in further understanding the requirements in ED-315.

Overall, we appreciate that the depth of the requirements in ED-315 for the system of internal control aims to address the quickly evolving business environment. However, given the rapid changes in IT systems and related controls, we think that auditors will struggle to fully understand these controls and how to design efficient and effective tests of controls. Therefore, we recommend that additional interpretation and application resources be provided to auditors on issuance of ED-315.

- (b) *Have the requirements related to the auditor's identification of controls relevant to the audit been appropriately enhanced and clarified? Is it clear how controls relevant to the audit are identified, particularly for audits of smaller and less complex entities?*

The list of controls included in paragraph 39 provide a clearer picture of which controls are relevant to the audit.

- (c) *Do you support the introduction of the new IT-related concepts and definitions? Are the enhanced requirements and application material related to the auditor's understanding of the IT environment, the identification of the risks arising from IT and the identification of general IT controls sufficient to support the auditor's consideration of the effects of the entity's use of IT on the identification and assessment of risks of material misstatement?*

The newly introduced IT-related concepts and definitions are, for the most part, easy to read and comprehend. However, we think the application of this material will prove to be challenging. We think that there is likely to be a knowledge gap between the requirements of the auditor to understand the IT environment and IT applications and the training auditors typically have. Auditors are not, normally, also IT experts, and we believe it may be difficult for the average auditor to understand the IT environment in sufficient depth to translate that understanding into risks. While there is a list of risks arising from the use of IT, these risks are very general and for the most part, apply at the financial statement level (paragraph A145)). We recommend that ED-315 be revised to add additional examples of risks at the assertion level. Adding this detail will be very beneficial for auditors to appreciate the benefit of obtaining this understanding and how it influences the risk assessment and overall audit approach.

We also recommend that ED-315 provide more direction on how the information system impacts the audit work. It is sometimes difficult for the auditor to translate understanding of information systems and controls into identifying risk and designing an appropriate audit approach. Further, as noted above, it may not be feasible to involve IT specialists in the majority of audits, especially when IT auditors are a scarce resource in the marketplace.

6) *Will the proposed enhanced framework for the identification and assessment of the risks of material misstatement result in a more robust risk assessment? Specifically:*

(a) *Do you support separate assessments of inherent and control risk at the assertion level, and are the revised requirements and guidance appropriate to support the separate assessments?*

Yes. We support separate assessments of inherent and control risk at the assertion level and believe the revised requirements and guidance will assist the auditor to perform those separate assessments.

(b) *Do you support the introduction of the concepts and definitions of “inherent risk factors” to help identify risks of material misstatement and assess inherent risk? Is there sufficient guidance to explain how these risk factors are used in the auditor’s risk assessment process?*

Yes. We support the introduction of the concepts and definitions of “inherent risk factors”. We think these will assist in more accurately assessing the inherent risk of each risk of material misstatement identified.

(c) *In your view, will the introduction of the “spectrum of inherent risk” (and the related concepts of assessing the likelihood of occurrence, and magnitude, of a possible misstatement) assist in achieving greater consistency in the identification and assessment of the risks of material misstatement, including significant risks?*

Yes. We think that the introduction of “spectrum of inherent risk” will assist in achieving greater consistency in the identification and assessment of the risks of material misstatement. Please see our comments regarding significant risks below.

(d) *Do you support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and their relevant assertions? Is there sufficient guidance to explain how they are determined (i.e. an assertion is relevant when there is a reasonable possibility of occurrence of a misstatement that is material with respect to that assertion), and how they assist the auditor in identifying where risks of material misstatement exist?*

Yes. We support the introduction of the new concepts and related definitions of significant classes of transactions, account balances and disclosures, and their relevant assertions. With that said, we are concerned that the title assigned to significant classes of transactions, account balances and disclosures may result in confusion. ED-315 now includes two concepts with reference to their “significance”; however, “significance” is not assigned the same meaning for these two concepts. For the sake of clarity, we recommend retaining the term ‘significant risk’ as it is already used in extant-315 and is widely understood. However, we recommend revising ED-315 to include an alternative term in reference to classes of transactions, account balances and disclosures. Perhaps ‘material’, ‘relevant’ or ‘principal’ would work.

- (e) *Do you support the revised definition, and related material, on the determination of 'significant risks'? What are your views on the matters presented in paragraphs 57 of the Explanatory memos relating to how significant risks are determined on the spectrum of inherent risk?*

Yes, overall, we support the revised definition, and related material, on the determination of 'significant risks'. However, we are concerned that the application of this definition may be difficult in some circumstances as it is not clear when a significant risk results when only one of likelihood or magnitude is assessed as high on the spectrum of inherent risk. We recommend adding examples of this concept to ED-315 to provide clarity to auditors in applying the revised definition.

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

Yes, we support the additional guidance in relation to the assessment of risks of material misstatement at the financial statement level.

- 8) *What are your views about the proposed stand-back requirement in paragraph 52 of ED-315 and the revisions made to paragraph 18 of ISA 330 and its supporting application material? Should either or both requirements be retained? Why or why not?*

We support the addition of the proposed stand-back requirement in paragraph 52 of ED-315 and believe this procedure allows users to exercise professional skepticism.

While we understand that this is likely outside the scope of what is being asked, we recommend that the Board consider whether the requirements outlined in paragraph 18 of ISA 330 continue to be necessary, given the robustness of the risk assessment process in ED-315. In our opinion, the improvements to the risk assessment process should provide the auditor adequate confidence that all risks have been identified and appropriately assessed. Thus, we feel that the work effort of substantive procedures on a balance, even a material balance, where no risk has been identified, may not be necessary to support the audit opinion.

- 9) *With respect to the proposed conforming and consequential amendments to:*

- (a) *ISA 200 and ISA 240, are these appropriate to reflect the corresponding changes made in ISA 315 (Revised)?*
- (b) *ISA 330, are the changes appropriate in light of the enhancements that have been made in ISA 315, in particular as a consequence of the introduction of the concept of general IT controls relevant to the audit?*
- (c) *The other ISAs as presented in Appendix 2, are these appropriate and complete?*
- (d) *ISA 540 and related conforming amendments (as presented in the Supplement to this exposure draft), are these appropriate and complete?*

We have no further comments with respect to the proposed conforming and consequential amendments.

- 10) *Do you support the proposed revisions to paragraph 18 of ISA 330 to apply to classes of transactions, account balances or disclosures that are 'quantitatively or qualitatively material' to align with the scope of the proposed stand-back in ED-315?*

Please refer to our response to question 8 above.

- 11) *In addition to the requests for specific comments above, the IAASB is also seeking comments on the matters set out below:*

- (a) *Translations – recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issue respondents note in reviewing the ED-315?*

We have no comments on translations.

- (b) *Effective date – Recognizing that ED-315 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.*

Given the substantive revisions to ED-315, we recommend providing an effective date that is a minimum of 24 months after the approval of the final ISA. Not only does ED-315 impact our audit methodology, but it will also require extensive training to our audit teams. Allowing sufficient time to revise methodologies and train staff will result in a more comprehensive understanding and interpretation of the changes which will then result in the most appropriate application. Implementing an effective date that is too early after approval of a final ISA is likely to result in rushed implementation and inconsistency in adoption.

Yours truly,

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