



**Lebanese Association of Certified Public Accountants**

# ISA 315

**Identifying and Assessing the Risks of  
Material Misstatement Through  
Understanding the Entity and Its Environment**

**September 18, 2108**

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**LACPA CPE Continuing Professional Education**

Exposure Draft  
July 2018  
Comments due: November 2, 2018

Supplement to Exposure Draft  
August 2018  
Comments due: November 2, 2018

*International Standard on Auditing*

Proposed International Standard  
on Auditing 315 (Revised)

Identifying and Assessing the  
Risks of Material Misstatement

and

Proposed Consequential and  
Conforming Amendments to  
Other ISAs

*International Standard on Auditing*

ISA 315 (Revised), Identifying  
and Assessing the Risks of  
Material Misstatement—  
Proposed Conforming  
Amendments to ISA 540  
(Revised) and ISA 200  
(Paragraph A42)



# ISA 315

Identifying and Assessing the Risks of Material  
Misstatement

*Through Understanding the Entity and Its Environment*

is one of the ISAs redrafted by the IAASB as part  
of its Clarity Project.



# IAASB Clarity Project

In serving the public interest, the International Auditing and Assurance Standards Board (IAASB) sets high-quality international auditing and assurance standards.

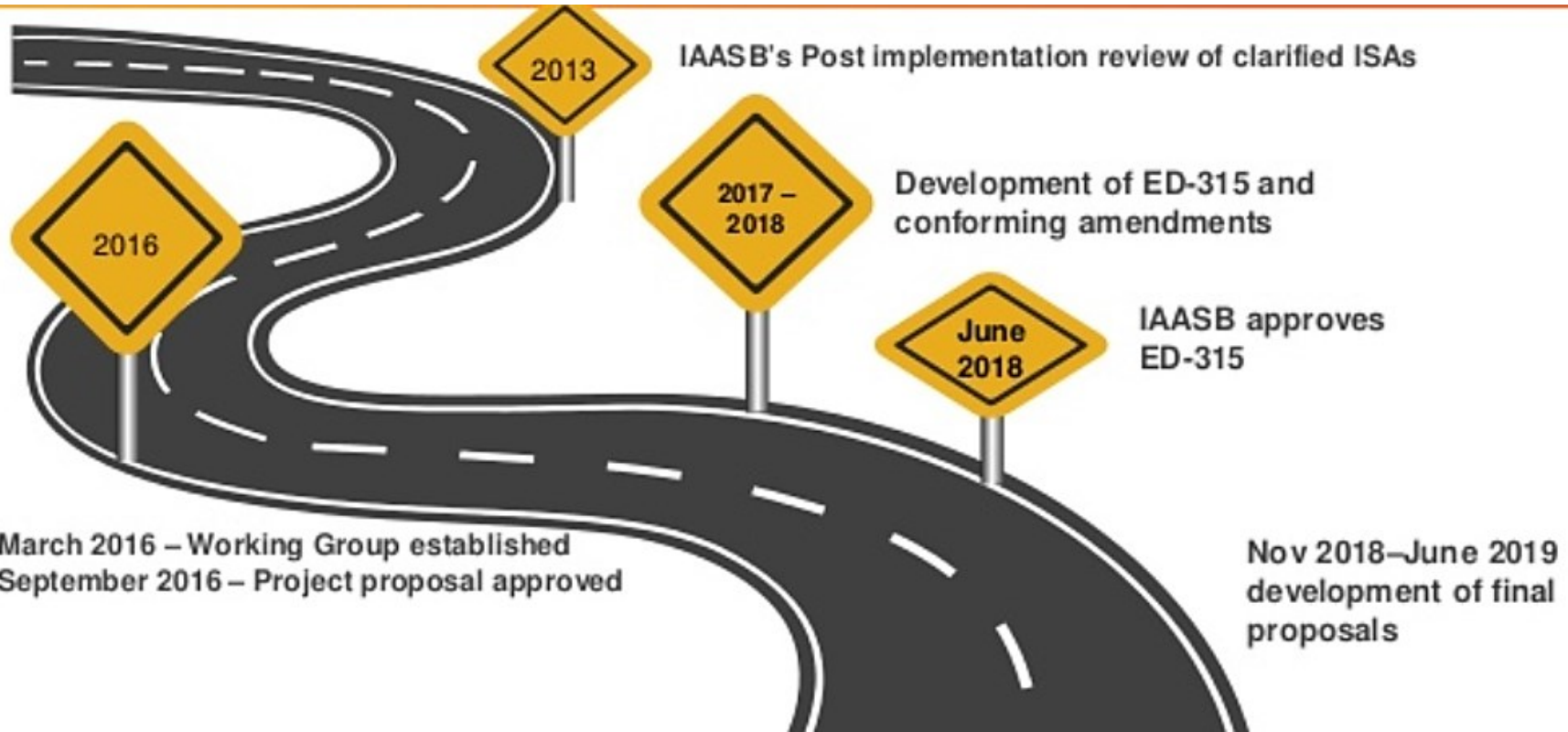
The IAASB recognizes that standards need to be:

- ***Understandable,***
- ***clear, and***
- ***capable of consistent application.***

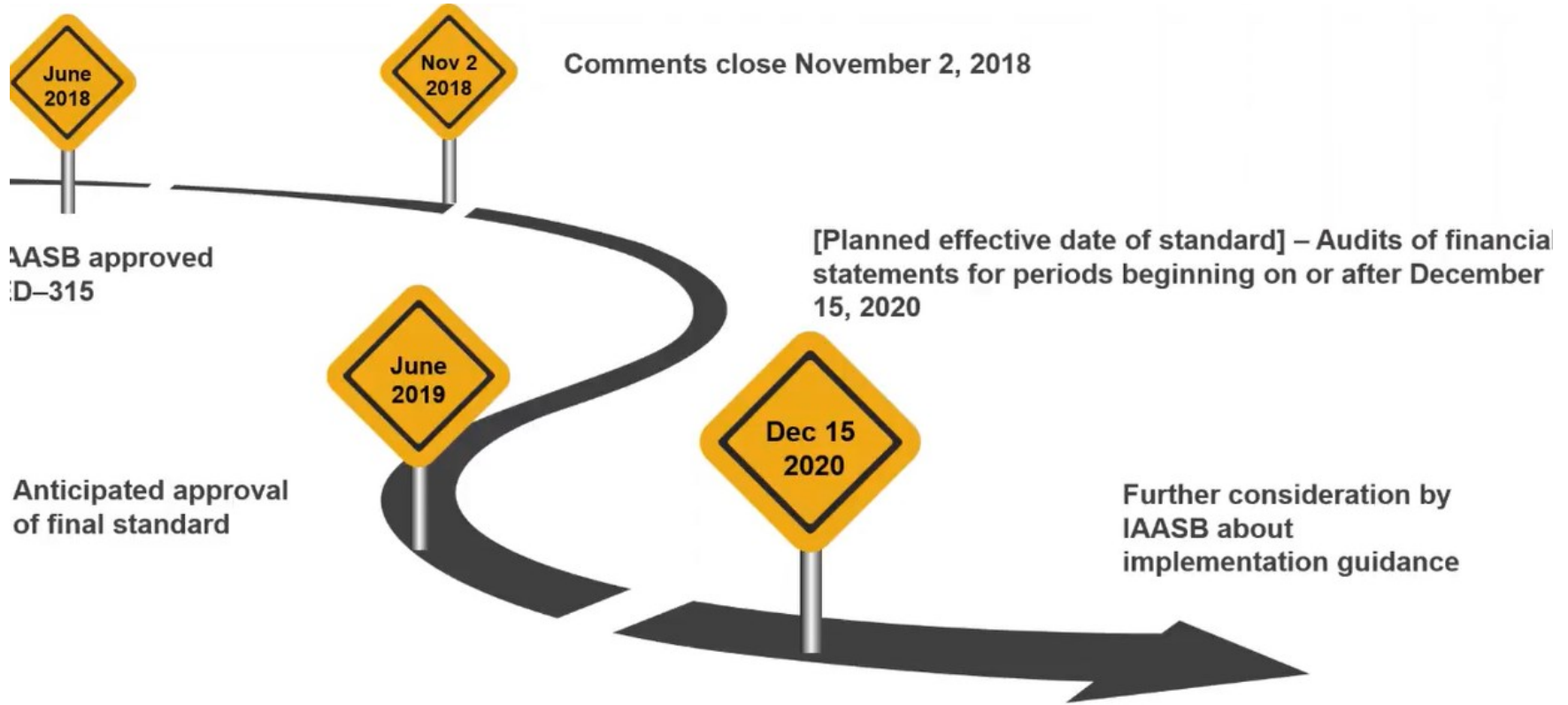
These aspects of clarity serve to enhance the quality and uniformity of practice worldwide.



# The Journey So Far



# The Way Forward



## البيانات المالية خالية من الأخطاء الجوهرية

### Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

ما هي الأخطاء؟  
وما هي الجوهرية؟

# **INTERNATIONAL STANDARD ON AUDITING 320**

## **MATERIALITY IN PLANNING AND PERFORMING AN AUDIT**

(Effective for audits of financial statements for periods  
beginning on or after December 15, 2009)





# What is Materiality in Audit?

## **Objective**

8. The objective of the auditor is to apply the concept of materiality appropriately in planning and performing the audit.

## **Definition**

9. For purposes of the ISAs, performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

## Documentation

The auditor shall include in the audit documentation the following amounts and the factors considered in their determination\*:

- (a) Materiality for the financial statements as a whole:
- (b) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures.
- (c) Performance materiality, and
- (d) Any revision of (a)-(c) as the audit progressed.

\* ISA 230. "Audit Documentation." paragraphs 8-11, and A6.

The term 'misstatement' is not defined in ISA 315,

but in ISA 450, *Evaluation of Misstatements Identified During the Audit*, which contains this definition:

*'a difference between the amount, classification, presentation or disclosure of a reported financial statement item and the amount, classification, presentation or disclosure that is required for the item to be in accordance with the applicable financial reporting framework.'*

A tolerable **misstatement** is the amount by which a financial statement line item can differ from its true amount without impacting the fair presentation of the entire financial statements.

The concept is used by **auditors** when designing **audit** procedures to examine the financial statements of a client.



## Misstatements can arise from fraud or error.'

In other words, a misstatement arises where there is a ***difference between the reported figures, and what is expected to be reported in order for the financial statements to be fairly presented***

(or show a true and fair view).

# What is a 'misstatement'?



## ISA 315 Requirements from Auditor

**Discuss** the **susceptibility** of the entity's financial statements to material misstatement, and that the engagement partner determines which matters are to be **communicated** to the rest of the audit team.

The **Discussion** should place emphasis on any indicators that the financial statements may be at risk of material misstatement due to fraud. (ISA 240.15) This discussion, and the significant decisions reached must be documented.



# ISA 315 (Revised) Exposure Draft (ED-315)

## Approved in June 2018:

- Includes conforming amendments to other ISAs – conforming amendments to approved ISA 540 (Revised) posted in August 2018
- **Comments close November 2, 2018**

### **Project objectives:**

- To establish a **more appropriate risk assessment**, including a **focus on scalability**
- To deal with **rapidly changing business and audit environment** (technology)
- To **enhance the application of professional skepticism** when performing risk assessment procedures
- To clarify the **nature and extent of the auditor's understanding of internal control**
- Development of **non-authoritative guidance / tools to support implementation** (as appropriate)



# ISA 540 - Auditing Accounting Estimates, Including Fair Value Accounting Estimates, And Related Disclosures

This International Standard on Auditing (ISA) deals with the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates, and related disclosures in an audit of financial statements. Specifically, it expands on how ISA 3151 and ISA 3302 and other relevant ISAs are to be applied in relation to accounting estimates. It also includes requirements and guidance on misstatements of individual accounting estimates, and indicators of possible management bias.





# What Should I Know

## Iterative nature of standard

- ISAs are written in linear manner - many aspects of ED-315 interconnected and often performed by auditors in an iterative manner
  - Firms may have different approaches - for example, the order in which risks of material misstatement, the significant classes of transactions, account balances or disclosures, a relevant assertions are identified.

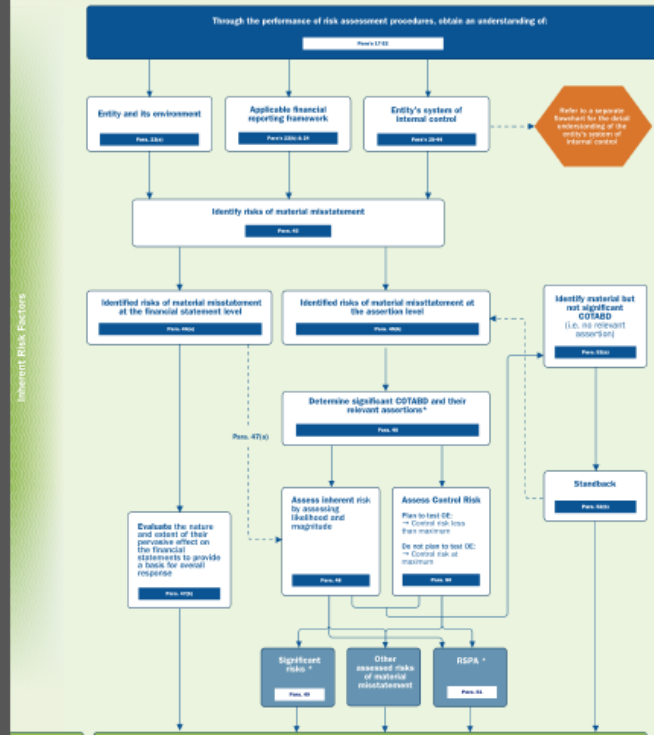
New introductory paragraphs provide a summary of the flow of the standard also highlighting its iterative nature

Flowcharts have been developed as guidance for the flow of the standard - IAASB website



# ISA 315 (Revised) Identifying and Assessing the Risks of Material Misstatement

## Professional Judgment and Professional Skepticism



Inherent Risk Factors

Documentation (ISA 330 and Para. 54 of ISA 315 (revised))

Iterative Process\*\*

**Audit responses**  
ISA 330

- Activities**
- (1) COVABD: Classes of transactions, account balances or disclosures
  - (2) SR: Significant risks
  - (3) SR: Risks of material misstatement for which substantive procedures alone do not provide sufficient evidence for audit opinion
  - (4) CE: Identifying deficiencies of controls

- Notes**
- \* The determination of significant COVABD, SR and SRB, is performed after the auditor obtains an understanding of the entity's system of internal control.
  - \*\*The risk assessment process is a dynamic and iterative process of gathering, updating and evaluating information and evidence throughout the audit.

# ISA 315 (Revised) Identifying and Assessing the Risks of Material Misstatement

## Professional Judgment and Professional Skepticism

Through the performance of risk assessment procedures, obtain an understanding of:

Para's 17-22

Entity and its environment

Para. 23(a)

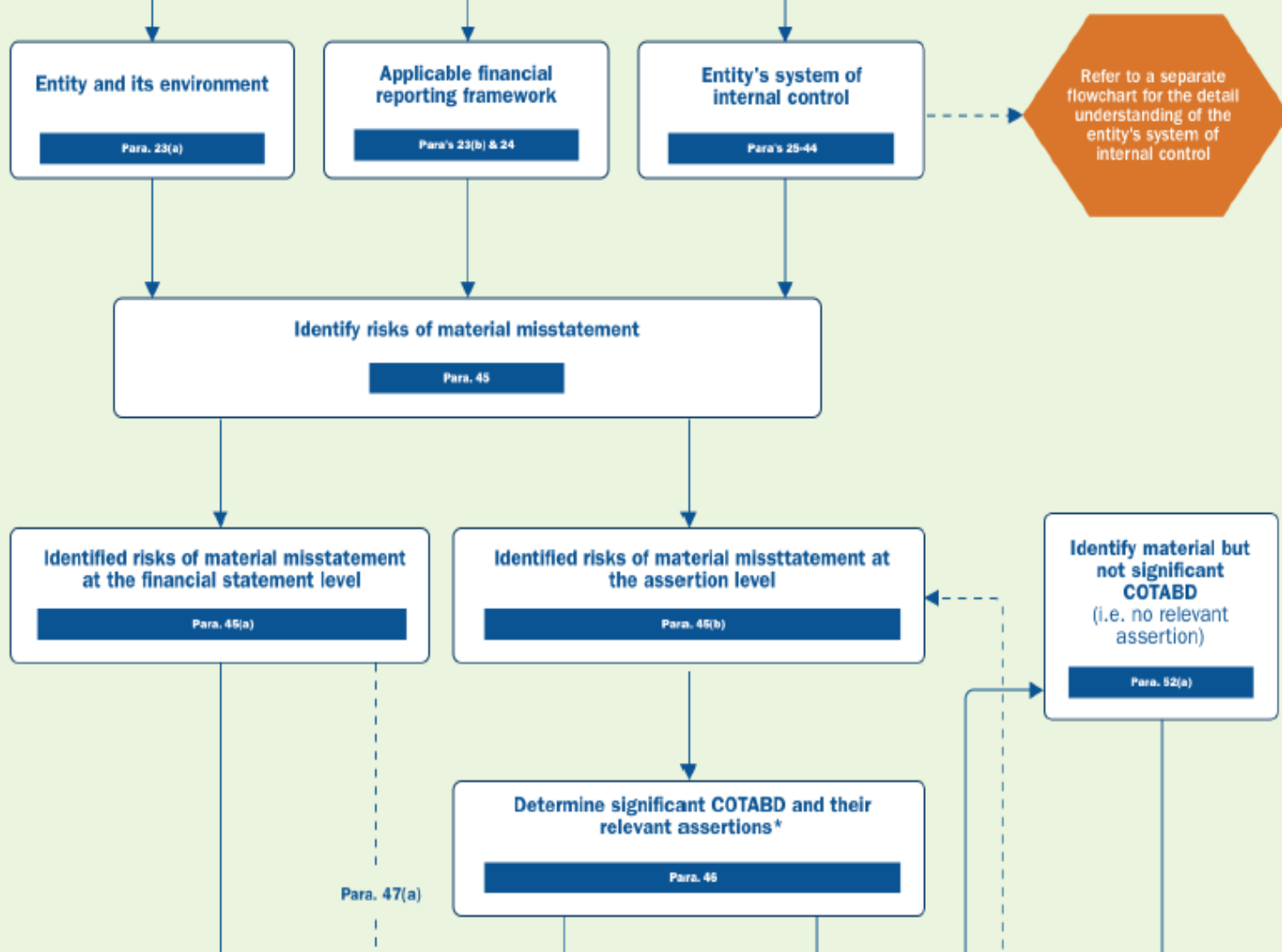
Applicable financial reporting framework

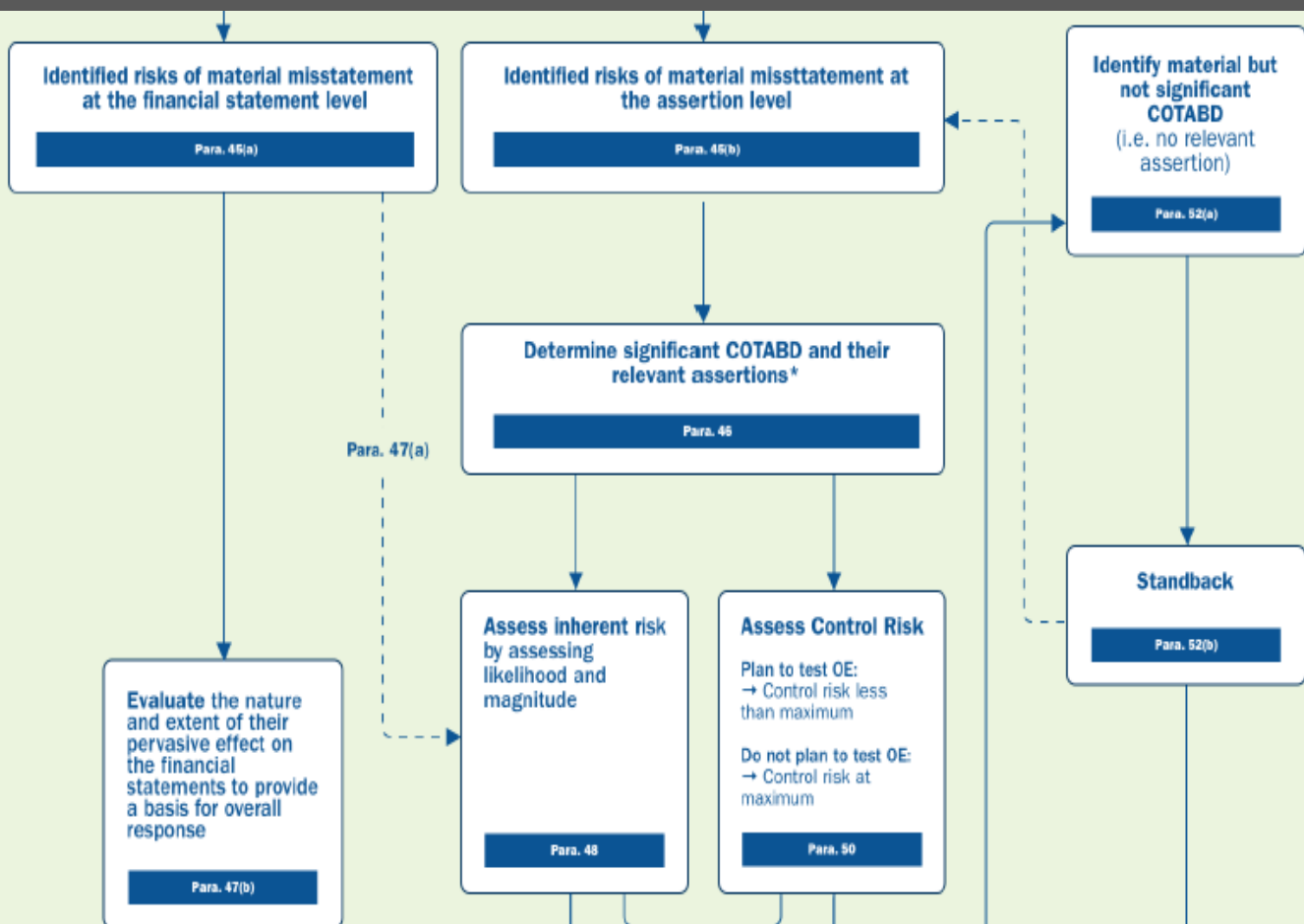
Para's 23(b) & 24

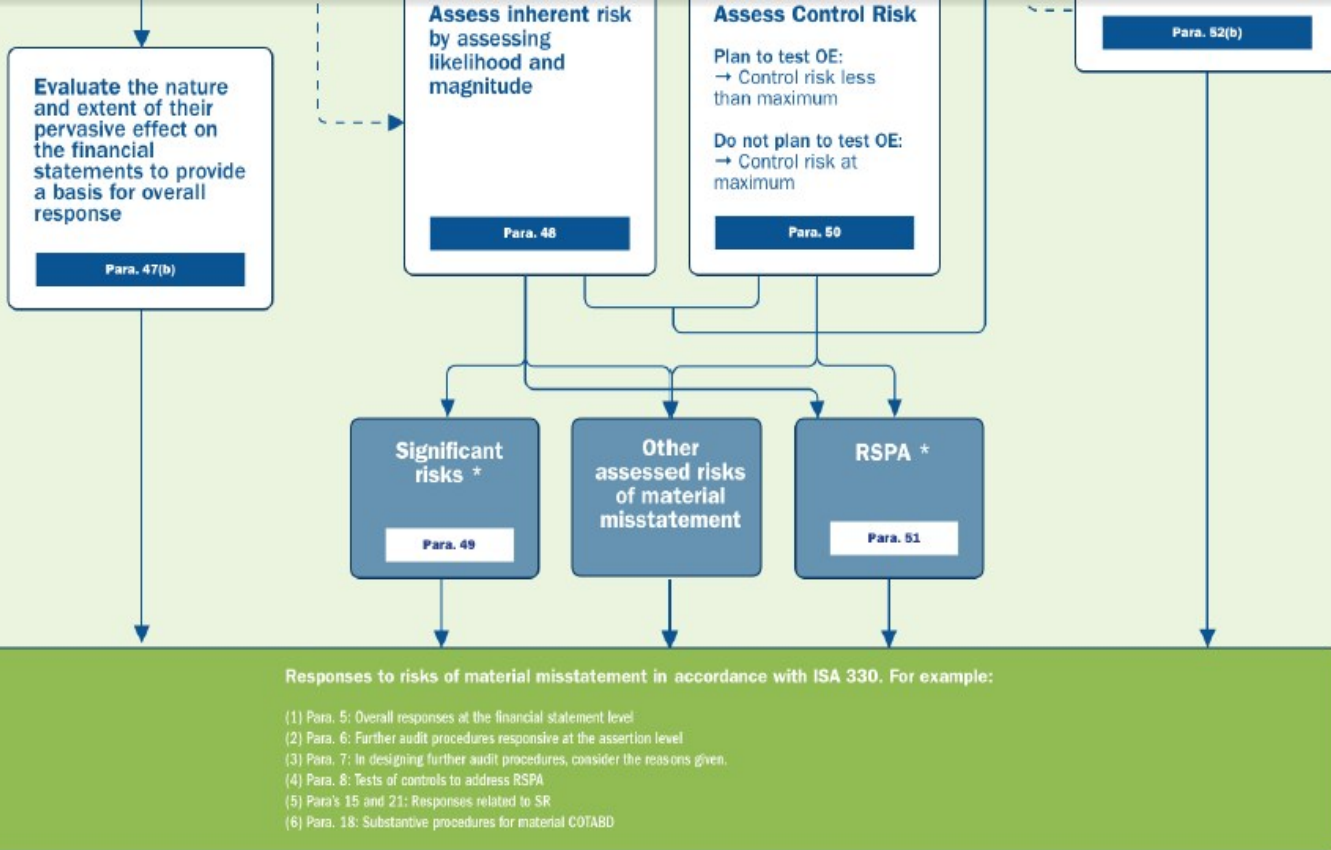
Entity's system of internal control

Para's 25-44

Refer to a separate flowchart for the detail understanding of the entity's system of internal control







**Audit responses  
ISA 330**

**Acronyms:**

- 1. COTABD - Classes of transactions, account balances or disclosures
- 2. SR - Significant risks
- 3. RSPA - Risks of material misstatement for which substantive procedures alone do not provide sufficient appropriate audit evidence
- 4. OE - Operating effectiveness of controls

**Notes**

- \* The determination of significant COTABD, SR and RSPA, in particular, affect the the required understanding of the entity's system of internal control.
- \*\*The risk assessment process is a dynamic and iterative process of gathering, updating and analyzing information and continues throughout the audit.

# ISA 315 (Revised) - Overall

- General
  - **Scalability**
    - Application material included for entities that are both 'smaller and less complex'
    - Removed specific 'considerations specific to smaller entities' – built into text as appropriate
  - **Automated tools and techniques** (including data analytics)
    - Application material provide examples of how automated tools and techniques are being used
    - The broader term 'automated tools and techniques' is used versus 'data analytics'
  - The auditor's considerations relating **to fraud**
    - Throughout the standard
    - New introductory paragraphs highlights and included in new concept of *inherent risk factors*
  - **Professional skepticism**
    - ED-315 includes key provisions to enhance the auditor's exercise of professional skepticism



# Key Enhancements

## Risk Assessment Procedures

- Performed to provide a 'sufficient and appropriate' audit evidence as the basis for identifying and assessing risks of material misstatement

## Understanding the Entity and its Environment

- Enhanced understanding, more focus on the entity's
  - Business model
  - Use of IT
- Interaction of this understanding with *inherent risk factors*

## Understanding the Applicable Financial Reporting Framework

- Greater focus on importance of financial reporting in identifying risks of material misstatement





## المرسوم رقم 4665 الصادر عام 1981

### الفصل الثاني :- في اصول مسك المحاسبة

#### المادة 6

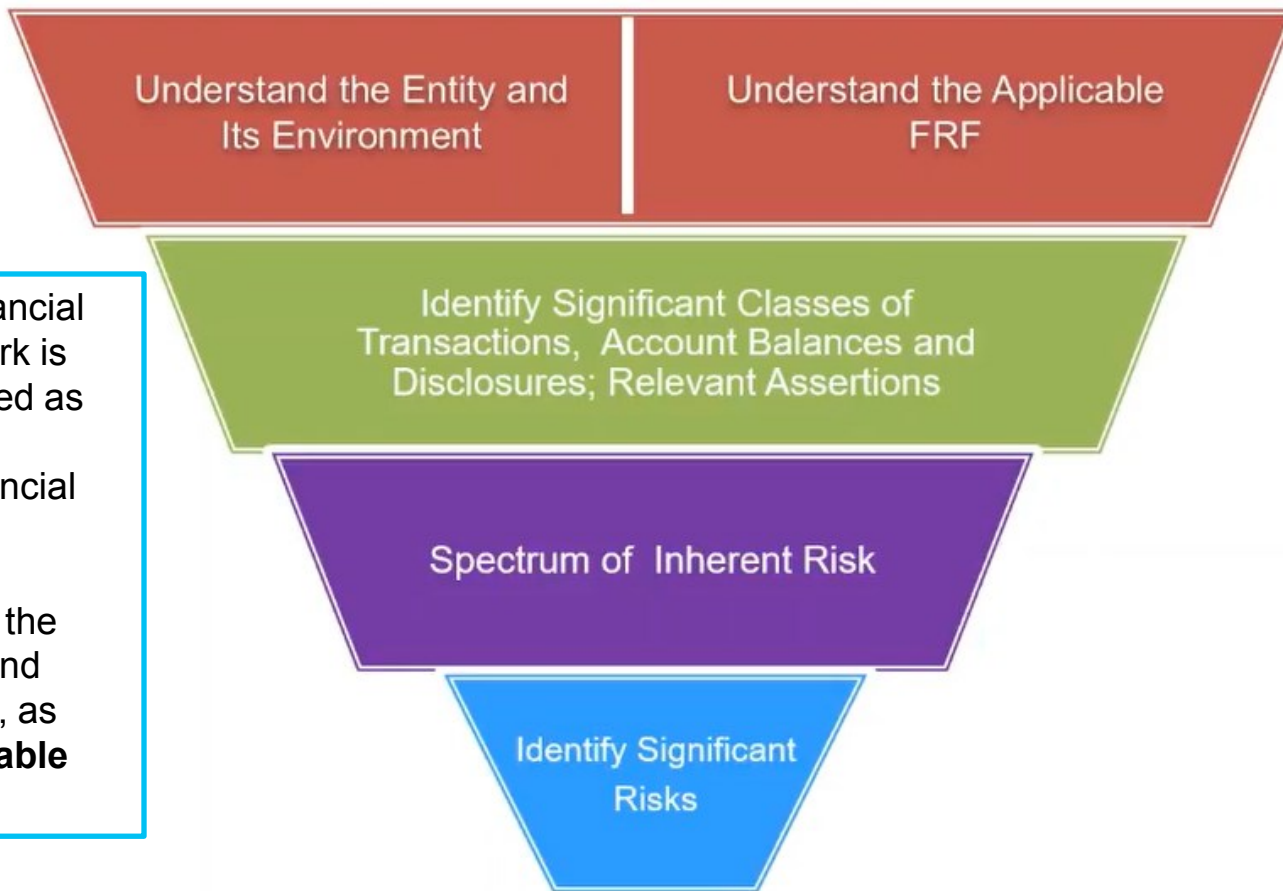
- أيا كانت القواعد والاساليب المحاسبية المعتمدة من قبل المؤسسة لا بد لهذه الاخيرة من التقيد بالموجبات المقررة في مجالي الاثبات والاعلام، ويقتضي لذلك:
- استعمال طريقة القيد المزدوج لضمان متابعة العمليات واجراء التدقيق المحاسبي.
  - وجود مستندات مثبته لصحة القيود المحاسبية.
  - تسجيل العمليات وفقا لتسلسلها التاريخي.
  - مسك دفاتر المحاسبة التي تمكن من الحصول على البيانات المالية وتدقيقها وفقا لمتطلبات التصميم المحاسبي العام.
  - وجود رقابة داخلية موثوقة قادرة على:
  - تدارك الاغلاط والغش
  - المحافظة على موجودات المؤسسة ومواردها.
  - تأمين التسجيل المحاسبي الصحيح لسائر العمليات المالية.
  - تنظيم جردة بعناصر وقيم موجودات ومطلوبات المؤسسة في نهاية الدورة المالية.

#### المادة 7

يجب اسناد كل تسجيل محاسبي الى وثيقة ثبوتية تنظم بصورة توفر الضمان اللازم للاثبات وتبين مصدر ومحتوى كل واقعة.



# SA 315 (Revised) – Overview of the Inherent Risk Assessment Process



An **applicable** financial reporting framework is the set of rules used as guidelines in the preparation of financial statements. The framework used is typically based on the type of business and where it is located, as well as the **applicable** laws

# SA 315 (Revised) - Understanding the Entity's System of Internal Control

Definitions	
New	Revised
Application controls	Controls
General IT controls	Access controls (glossary)
IT environment	

Components of Internal Control
1. Control environment
2. The entity's risk assessment process
3. The entity's process to monitor the system of internal control
4. The information system and communication
5. Control activities

- Maintained the 5 components of internal control
  - Enhanced as necessary to align with COSO
- Controls definition
  - Recognizes 'less formalized' policies and procedures (scalability)

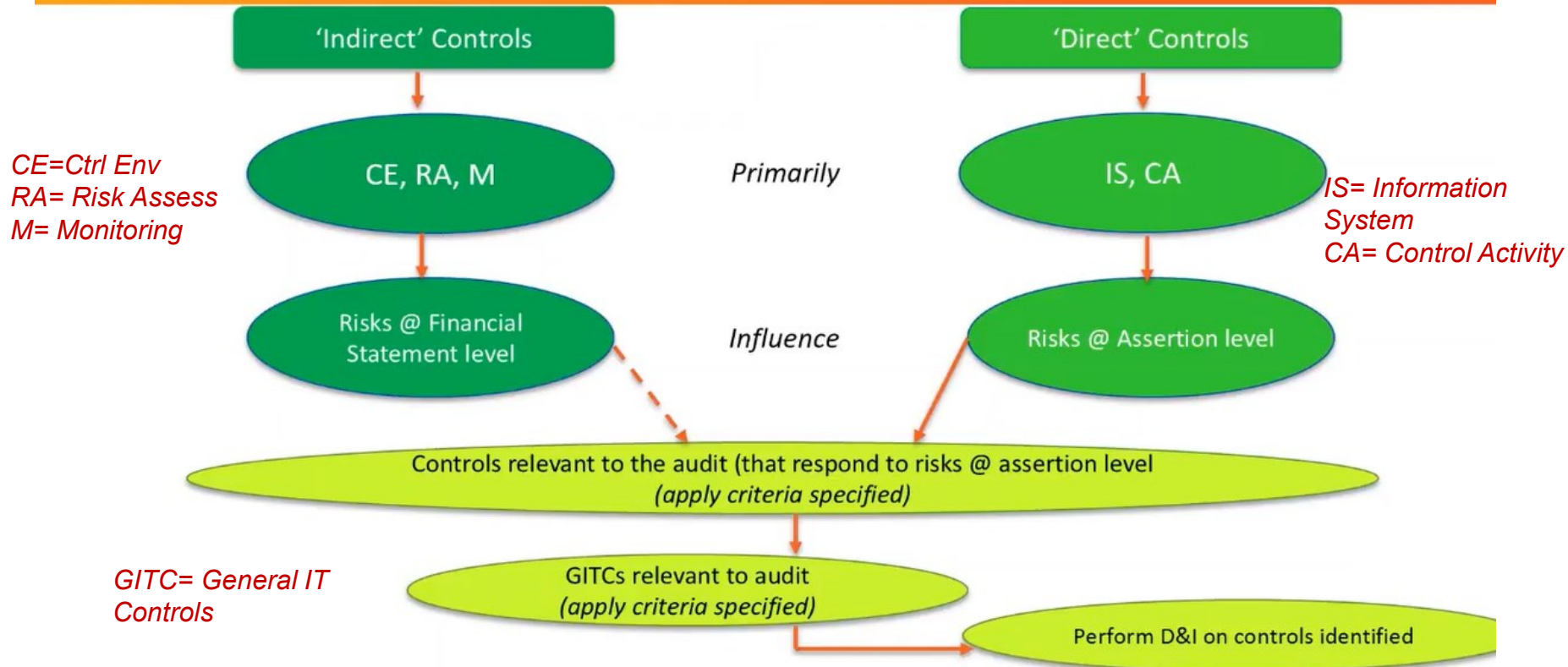


# SA 315 (Revised) - Understanding the Entity's System of Internal Control

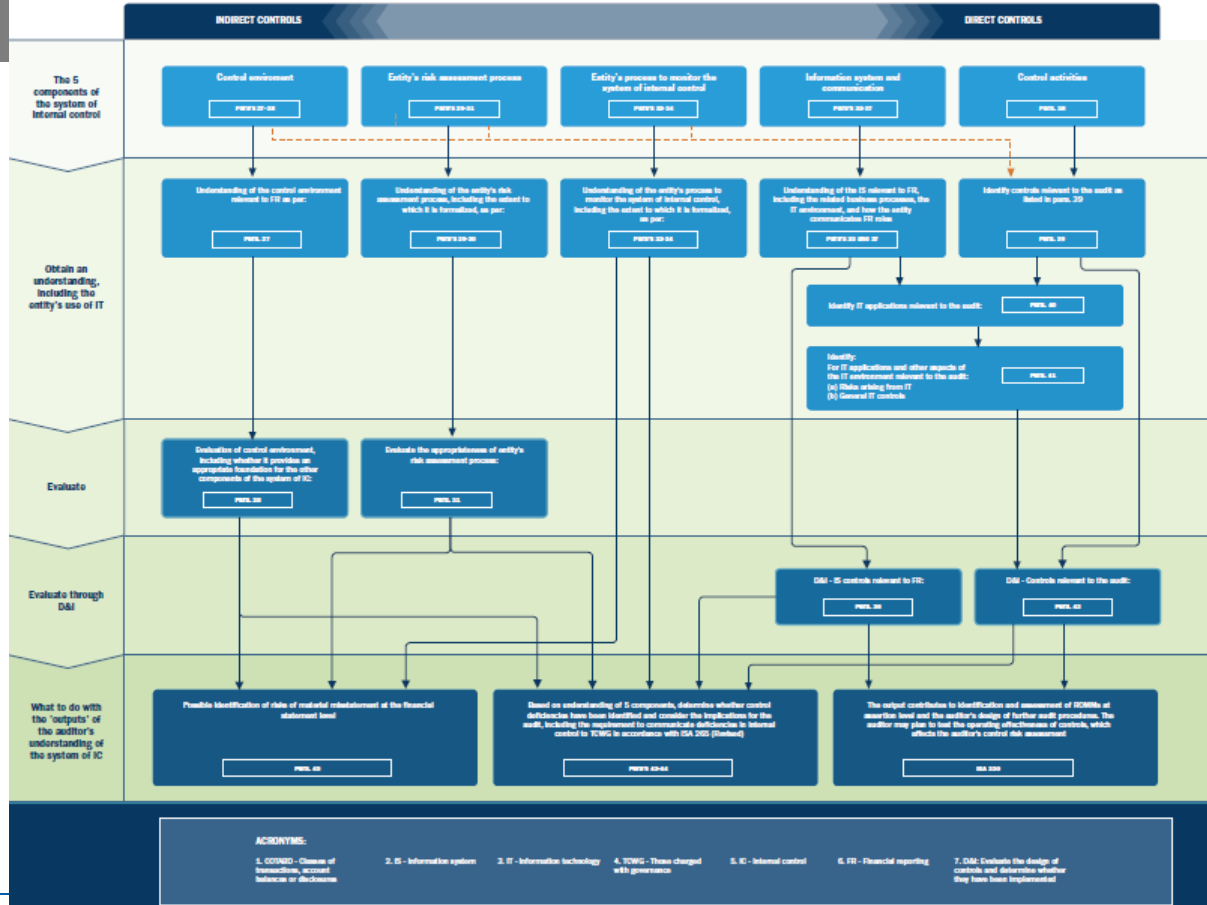
- More specificity about what '*controls relevant to the audit*' means
  - Clarifying when **evaluating the design of controls and determining whether implemented** (D&I) is required
- Clarified the work effort in relation to: *D&I = Design & Implementation*
  - Understanding each component of the system of internal control
  - Understanding the information system, including information system controls relevant to financial reporting
    - Application material provides guidance to distinguish 'information system controls' from 'controls relevant to the audit'
  - Application controls and general IT controls relevant to the audit
- Enhanced responsibility to identify and determine further action if necessary relating to deficiencies in the system of internal control in relation to all the components



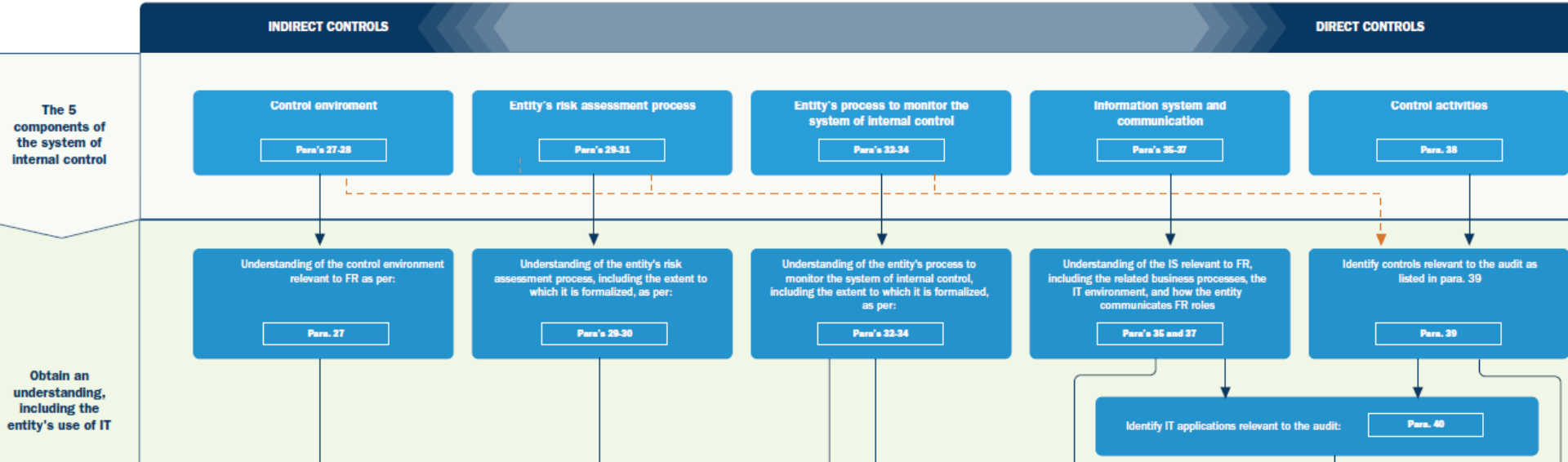
# SA 315 (Revised) - Understanding the Entity's System of Internal Control

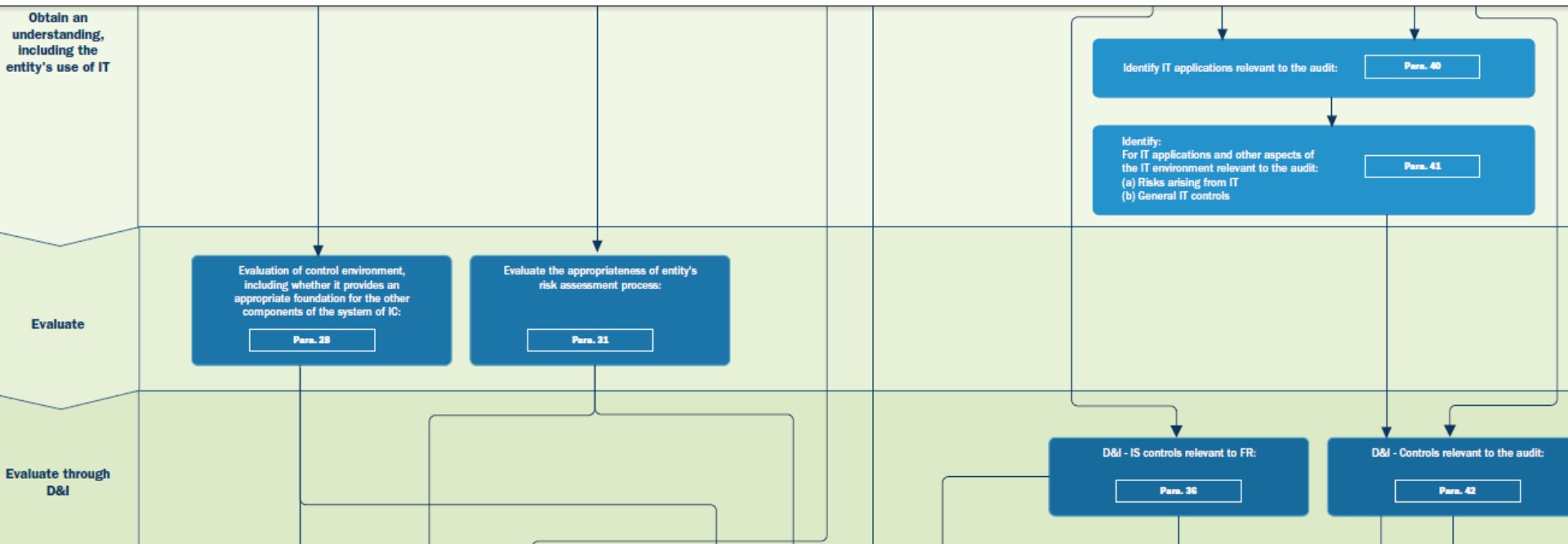


Obtaining an Understanding of the Entity's System of Internal Control – ISA 315 (Revised) Para. 25–44

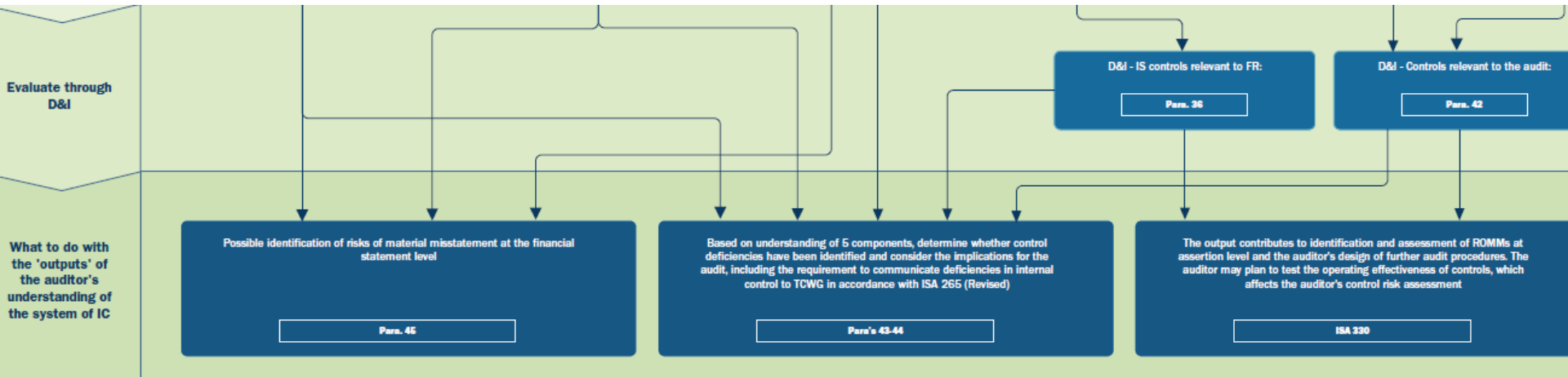


## Obtaining an Understanding of the Entity's System of Internal Control – ISA 315 (Revised) Para. 25–44









**ACRONYMS:**

1. COTABD - Classes of transactions, account balances or disclosures

2. IS - Information system

3. IT - Information technology

4. TCWG - Those charged with governance

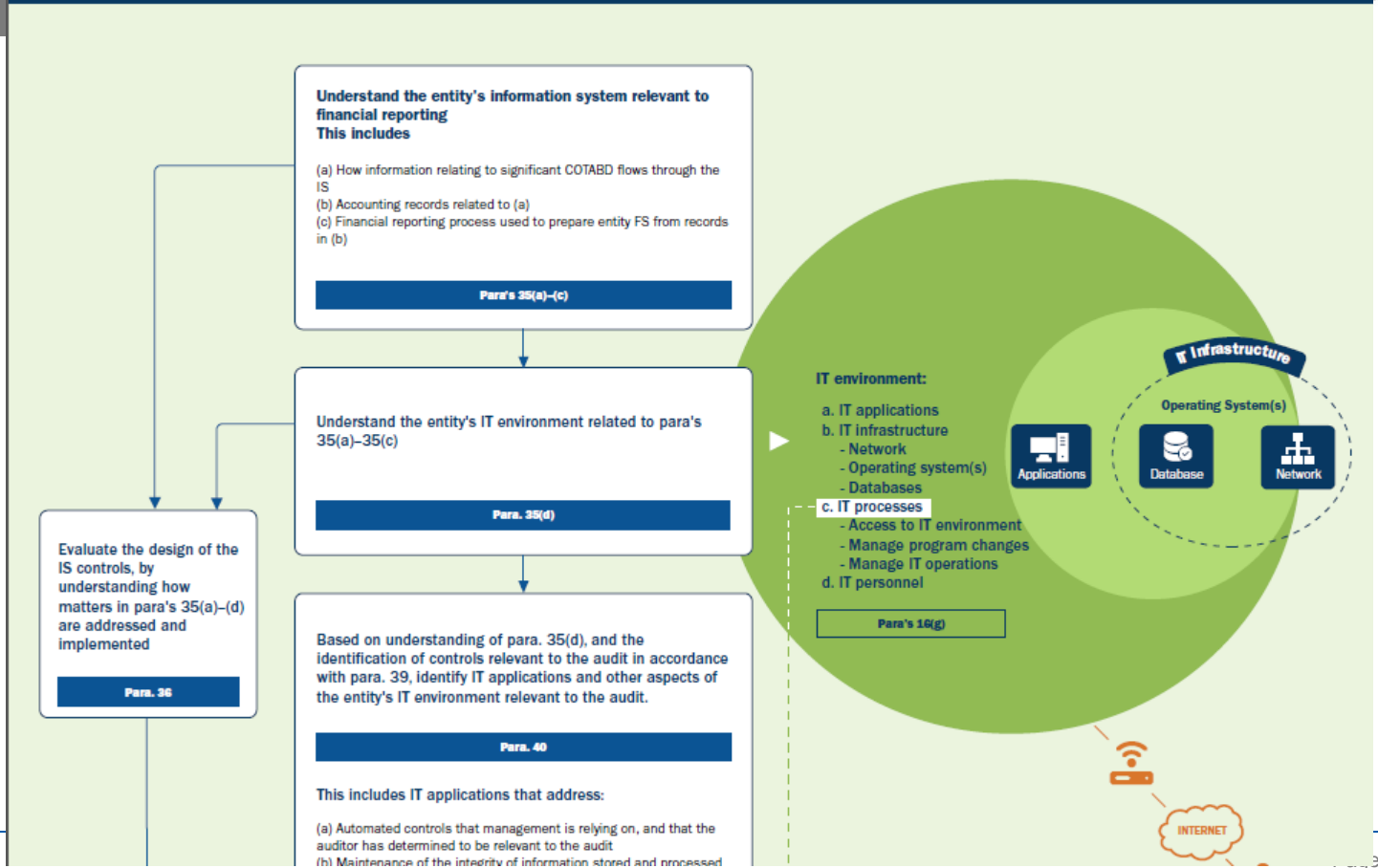
5. IC - Internal control

6. FR - Financial reporting

7. D&I: Evaluate the design of controls and determine whether they have been implemented







**Para. 40**

This includes IT applications that address:

- (a) Automated controls that management is relying on, and that the auditor has determined to be relevant to the audit
- (b) Maintenance of the integrity of information stored and processed in IS that relates to significant COTABD
- (c) System generated reports on which the auditor intends to rely without testing inputs & outputs
- (d) Controls that address RSPA

No IT applications relevant to the audit

IT applications relevant to the audit

No requirement to identify GITCs or evaluate the D&I of GITCs

For IT applications and other aspects of the IT environment that are relevant to the audit, identify

- (a) Risks arising from the use of IT
- (b) GITCs relevant to the audit.

**Para. 41 - See Appendix 4 for examples of GITCs**



INTERNET



Customers / Business Partners, Vendors etc.

GITCs include controls over the entity's IT processes

**GITCs definition**

Controls related to the IT environment that support the effective functioning of application controls or the integrity of information by helping to maintain the continued operation, as designed, of the entity's IS.

**Para. 16(e)**

**Para. 41 - See Appendix 4 for examples of GITCs**

**Para. 16(e)**

Evaluate the D&I of controls, including GITCs,  
relevant to the audit

**Para. 42**

The output contributes to the identification and assessment of ROMMs at the assertion level and the auditor's design of further audit procedures.  
The auditor may plan to test the operating effectiveness of controls, including GITCs, which affects the auditor's control risk assessment in accordance with para. 50 of ISA 315 (Revised).

#### ACRONYMS

1. COTABD - Classes of transactions, account balances or disclosures
2. IS - Information system
3. D&I - Evaluate the design of controls and determine whether they have been implemented
4. RSPA - Risks of material misstatement for which substantive procedures alone do not provide sufficient appropriate audit evidence
5. IT - Information technology
6. FS - Financial statements
7. GITCs - General IT controls

# ISA 315 (Revised) - Identifying and Assessing Risks of Material Misstatement

## Definitions

New	Revised
Inherent risk factors	Assertions
Relevant assertion	Significant risk
Significant classes of transactions, account balances or disclosures	

## Inherent risk factors include:

1. Complexity
2. Subjectivity
3. Uncertainty
4. Change
5. Susceptibility to misstatement due to management bias or fraud

## Key change in assessing risk of material misstatement

**Separate** assessment of inherent risk and control risk

## Concept of 'spectrum of inherent risk'

The degree to which inherent risk varies, is referred to as the 'spectrum of inherent risk' – consider likelihood and magnitude of material misstatement to determine where on the spectrum the risk lies



# A 315 (Revised) - Significant Risks

**Significant risk definition** – An identified risk of material misstatement:

For which the assessment of inherent risk is *close to the upper end of the spectrum of inherent risk* due to the degree to which one or a combination of the inherent risk factors affect the *likelihood of a misstatement* occurring or the magnitude of potential misstatement should that misstatement occur; or

That is to be treated as a significant risk in accordance with the requirements of other ISAs



## Significant risks – Other ISAs

*ISA 240 – para. 27*

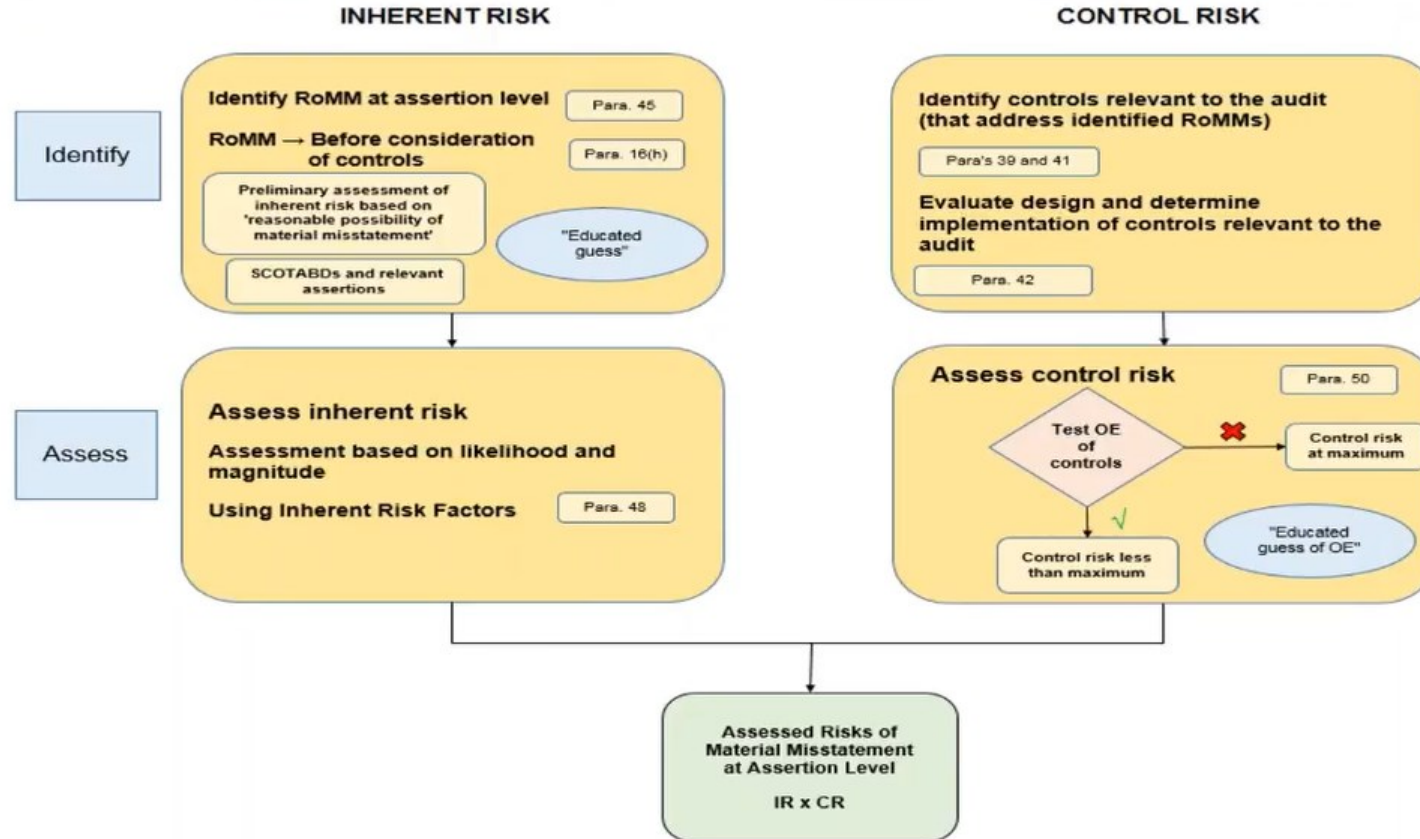
Presumption that there is a risk of fraud in revenue recognition

*ISA 550 – para. 18*

Identified significant related party transactions outside the normal course of business



# SA 315 (Revised) - Identifying and Assessing Risks of Material Misstatement





## What else is new or revised?

NEW stand-back requirement – i.e., no relevant assertion(s) for a class of transaction, account balance or disclosure

Material classes of transactions, account balances or disclosures

- ISA 330 para. 18 maintained; linked to stand back on non-significant classes of transactions, account balances or disclosures
- Conforming amendments to ISA 330 paragraph 18
- Specific question in ED-315 whether still need this requirement

Application material explains interaction of relevant assertions and significant classes of transactions, account balances or disclosures and how they are used in identifying risks



# Other Matters

- Documentation
  - More specificity relating to controls relevant to the audit
  - Identified and assessed ROMM – including significant risks and the rationale of related significant judgments
  - Although limited changes to documentation requirements, IAASB of the view that enhanced requirements will require more specific documentation, as a result of the requirements of ISA 230

## **ISA 230 paragraph 8:**

The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

- (a) The nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements;
- (b) The results of the audit procedures performed, and the audit evidence obtained;
- (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

# المطلوب من السادة الخبراء

- يشجعكم مجلس النقابة القيام بدراسة المعيار والتعديلات المقترحة عليه. وهي المرة الأولى التي يقوم مجلس النقابة بطرح إحصاء لمعرفة رأيكم في التعديلات المقترحة حول المعايير.
- لمن يرغب في ابداء رأيه بالتعديلات المقترحة على المعيار رقم 315 يرجى ارسال الآراء بواسطة البريد الالكتروني:

[vicepresident@lacpa.org.lb](mailto:vicepresident@lacpa.org.lb)

الأستاذ هشام المكمل

وذلك قبل 25/10/2018

- كما يرجى توجيه طلبات الاستفهام أو للمساعدة في الحصول على النصّ الرسمي باللغة الإنكليزية الجديد للمعيار رقم 315.

THANK YOU

Any Questions???



[www.lacpa.org.lb](http://www.lacpa.org.lb)

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