



Exposure Draft

Proposed Canadian Auditing Standard

Identifying and Assessing the Risks of Material Misstatement

September 2018

**COMMENTS TO THE IAASB AND THE AASB MUST BE RECEIVED BY
November 2, 2018**

**Respondents are asked to email their comment letters
(in a Word file) to:**

info@asbcanada.ca

Please address your comments to:

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Auditing and Assurance Standards Board

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This Exposure Draft reflects proposals made by the International Auditing and Assurance Standards Board that the Auditing and Assurance Standards Board (AASB) intends to adopt, subject to deliberating comments received, as Canadian generally accepted auditing standards.

Individuals and organizations are invited to send written comments on the Exposure Draft proposals. Comments are requested from those who agree with the Exposure Draft as well as from those who do not.

Comments are most helpful if they are related to a specific paragraph or group of paragraphs. Any comments that express disagreement with the proposals in the Exposure Draft should clearly explain the problem and include a suggested alternative, supported by specific reasoning. All comments received by the AASB will be available on the website shortly after the comment deadline, unless confidentiality is requested. The request for confidentiality must be stated explicitly within the response.

Highlights

The Auditing and Assurance Standards Board (AASB) proposes, subject to comments received following exposure, to adopt with appropriate amendments, if any:

- proposed International Standard on Auditing (ISA) 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*; and
- conforming and consequential amendments to:
 - ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*;
 - ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*;
 - ISA 330, *The Auditor's Responses to Assessed Risks*; and
 - 24 other ISAs where the volume of change is less extensive;¹

issued by the International Auditing and Assurance Standards Board (IAASB). The result would be revised respective Canadian Auditing Standards (CASs).

In its Exposure Draft of ISA 315 (Revised) the IAASB is also proposing to make conforming and consequential amendments to another standard, ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, which was only recently approved by the IAASB. At the time of issuing this Exposure Draft, the AASB has not approved the adoption of ISA 540 (Revised) as CAS 540 but will do so later this year. Accordingly, the conforming and consequential amendments to ISA 540 (Revised) resulting from the IAASB's Exposure Draft of ISA 315 (Revised) will not be considered by the AASB until the IAASB completes its due process and CAS 540 is finalized.

This Exposure Draft consists of:

- an explanation of why change was needed;
- key public interest considerations;
- proposed changes;
- a link to the IAASB's Exposure Draft, including its Explanatory Memorandum;
- a description of the AASB's process for adopting ISAs;
- a discussion of proposed significant Canadian amendments; and
- a proposed effective date.

Please review "**Comments requested**" on page iv for information on preparing your response to this Exposure Draft.

Why change is needed

The IAASB completed a post-implementation review following the clarification of the ISAs to determine whether they are being consistently understood and implemented. The results of the IAASB's post-implementation review were published in July 2013, of which there were several key themes related to ISA 315 (Revised).

¹ Appendix 2 to the IAASB's Explanatory Memorandum of its Exposure Draft contains an explanation of conforming amendments proposed but not presented in that Exposure Draft.

Included in the AASB's response to the IAASB's post-implementation review were the following findings specifically related to ISA 315 (Revised):

- Practitioners are unclear as to how understanding the components of internal control impacts the auditor's risk assessment procedures.
- Practitioners are unclear about what internal controls are "relevant to the audit." The application material does not provide examples of when control activities may be relevant to the audit. The result is that in many cases practitioners are including more activities than would be necessary.
- Practitioners are unclear about when a risk of material misstatement is a "significant risk" and the implications for the audit. They find the definition of significant risk is circular. As a result, practice inspectors find that auditors are not identifying risks as significant when they perhaps should be.

Key public interest considerations

All the proposed revisions in the Exposure Draft are made with public interest considerations at the forefront. Revisions that are most important in supporting the public interest are set out below. These proposed revisions respond to concerns raised in the post-implementation review of the ISAs related to ISA 315 (Revised):

- Clarifying and improving the identification and assessment of the risks of material misstatement to drive better risk assessment and enhance audit quality. The overarching themes of the revisions proposed include:
 - Understanding the entity's system of internal control, in particular relating to the auditor's work effort to obtain the necessary understanding and to identify "controls relevant to the audit";
 - Modernizing the standard in relation to information technology (IT) considerations, including assessing risks arising from IT; and
 - Determining significant risks;
- Addressing the complexity and iterative nature of the standard by including introductory paragraphs and flowcharts to summarize the flow of the auditor's risk-assessment process;
- Emphasizing the ability to apply the standard to the financial statements of all entities, by including in the application material considerations for audits of entities that are both smaller and less complex and for audits of larger, complex entities;
- Modernizing and updating the standard for an evolving business environment, including data analytics, IT and considerations relevant to public sector entities;
- Fostering an appropriate mindset of the auditor by including several provisions that are designed to enhance the auditor's exercise of professional skepticism; and
- Including appropriate linkages to the auditor's considerations relating to fraud.

Proposed changes

The Exposure Draft proposes several key changes, which include:

- focusing on the applicable financial reporting framework in identifying and assessing the risks of material misstatement;
- updating the understanding of the system of internal control, including clarifying the work effort for understanding each of the components of internal control and clarifying "controls relevant to the audit";

- updating aspects relating to IT, in particular to the IT environment, the IT applications relevant to the audit and general IT controls relevant to the audit;
- introducing the new concepts of:
 - inherent risk factors;
 - relevant assertions;
 - significant classes of transactions, account balances; and disclosures; and
 - the spectrum of inherent risk;
- enhancing application material to further explain how work performed on the design and implementation of controls relevant to the audit interacts with the auditor's assessment of control risk;
- separating the assessment of inherent risk and control risk in relation to risks of material misstatement at the assertion level;
- enhancing the requirements for the auditor's identification and assessment of risks at the financial statement level and the relationship of these risks to the risks of material misstatement at the assertion level;
- updating the definition of "significant risks"; and
- introducing a stand-back requirement for the auditor to evaluate whether all the significant classes of transactions, account balances and disclosures, and their relevant assertions, had been identified.

IAASB Exposure Draft

The IAASB's Exposure Draft, "[Identifying and Assessing the Risks of Material Misstatement](#)," is available on the IAASB website.

In addition to the text of proposed ISA 315 (Revised), the Exposure Draft includes the Explanatory Memorandum, which provides background to, and an explanation for, the proposed revisions to extant ISA 315.

Process for adopting ISAs

In adopting the ISAs as CASs, the AASB issues as a Canadian exposure draft every IAASB exposure draft of a proposed ISA. However, in doing so, the AASB recognizes that it has a vital role to play in monitoring changes made by the IAASB to ensure that standards remain in the Canadian public interest and that adoption of an ISA is not automatic. The AASB follows amendment criteria set out in the [Appendix](#) that allow the AASB to make amendments in specific circumstances.

The AASB normally uses the same effective date for the CASs as the IAASB does for the ISAs. The AASB makes CASs available shortly after they are approved, so Canadian auditors can become familiar with them and prepare to implement them by the effective date.

Proposed significant Canadian amendments

The AASB proposes no Canadian amendments to the proposed revised ISAs.

Proposed effective date

The IAASB proposes that the revised ISAs be effective for audits of financial statements for periods beginning on or after December 15, 2020. The revised CASs are expected to have the same effective date as the revised ISAs. Auditors will be permitted to apply these revised CASs before the effective date.

Comments requested

Comments are most helpful if they relate to a specific paragraph or group of paragraphs. Any comments that express disagreement with the proposals in the Exposure Draft should clearly explain the problem and include a suggested alternative, supported by specific reasoning. When a respondent agrees with proposals in the Exposure Draft, it will be helpful for the AASB to be made aware of this view.

Responding to the IAASB's Exposure Draft

The AASB encourages Canadian stakeholders to respond to the IAASB on its Exposure Draft. Specific questions on which the IAASB would like input are provided in the "Request for Comments" section of the IAASB Exposure Draft. The AASB requests that comment letters be sent directly to the IAASB with a copy to the AASB. The AASB will consider such copies received by October 1 in drafting its own response to the IAASB Exposure Draft. Respondents are asked not to include comments on matters particular to the Canadian environment in their responses to the IAASB. Such comments should be included only in responses sent to the AASB.

Providing comments to the AASB

In responding to the questions in the IAASB's Exposure Draft and the questions below, the AASB invites firms of all sizes to field test the requirements in proposed CAS 315 and communicate the outcome in its response letter. Lessons learned from field testing will provide the AASB with a better understanding of the proposals' practical implications.

The AASB would appreciate receiving responses to the questions set out below, in addition to receiving a copy of the response to the IAASB's Exposure Draft.

1. Do you believe the AASB should make any Canadian amendments to the proposed ISAs? If so, please include your reasoning and describe their nature and extent. Any proposed amendments would need to meet the criteria set out in the Appendix.
2. Do you believe any of the requirements in the proposals could create initial implementation difficulties, despite the guidance provided? If so, please explain.

Responses to these additional questions should be sent directly to the AASB.

You may email your comments (in a Word file) to: info@asbcanada.ca.

The deadline for responding to the IAASB on its Exposure Draft is November 2, 2018.

If you would like your response letter to be considered by the AASB in drafting its own response to the IAASB's Exposure Draft, please submit it early, by October 1, 2018.

Appendix

Criteria for amending ISAs when adopting them as CASs

With respect to the adoption of ISAs, the AASB's overriding goal is to adopt ISAs into the CPA Canada Handbook – Assurance without amendment. However, there may be circumstances when amendments are required. The following sets out the limited circumstances when the AASB will make amendments to ISAs:

1. The AASB limits additions to an ISA to those required to comply with Canadian legal and regulatory requirements.¹
2. The AASB limits deletions from, or other amendments to, an ISA to the following:
 - (a) The elimination of options (alternatives) provided for in the ISA.
 - (b) Requirements or guidance, the application of which Canadian law or regulation does not permit, or which require amendments to be consistent with law or regulation.
 - (c) Requirements or guidance, where the ISA recognizes that different practices may apply in different jurisdictions and Canada is such a jurisdiction.
3. The AASB may make amendments to an ISA with respect to requirements or guidance that do not fall within 1 or 2 above when it believes that there are circumstances particular to the Canadian environment where such amendments are required to serve the Canadian public interest and maintain the quality of auditing and reporting in Canada.
4. To the extent possible, amendments that are:
 - (a) additions to an ISA will not be inconsistent with the current requirements or guidance in the ISA; and
 - (b) deletions from, or other amendments to, an ISA will be replaced by an appropriate alternative that achieves the objective of the deleted requirement.

Proposed amendments to an ISA are highlighted in exposure drafts of proposed Canadian standards. The AASB indicates the reasoning for the amendments and respondents are invited to comment on them, including when the amendment will not result in convergence with the ISA in accordance with the IAASB's guide for national standard setters. Amendments to ISAs are separately identified in the final Handbook material.

¹ Canadian incorporating and other governing legislation often requires entities to prepare financial statements in accordance with Canadian generally accepted auditing principles (GAAP). Accordingly, if Canadian GAAP necessitates a different audit response in Canada, these differences fall within the definition of a legal or regulatory requirement.

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