RISK ASSESSMENT IN THE EXTERNAL AUDIT

**ICAJ/PAB WEBINAR
AUDIT IN A DYNAMIC ENVIRONEMENT:**
Be in the know!

May 16, 2023

Opening Remarks

- Change is constant !?

- Reflect on events over the past two to three years…..

- Fast forward your thoughts to the next two to three years…….

- …….A DYNAMIC ENVIRONMENT INDEED!!!
- What are the implications for RPAs and the profession?

Risk assessment

- What is risk assessment??
- Has it changed, if at all?

- In the context of the external audit, guidance can be found :
  - ISA 315 (revised 2019) - Identifying and assessing the risks of material misstatement;
  - ISA 330 - The auditor's response to assessed risks;
  - 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 230 – Audit documentation

RISK ASSESSMENT

- Arguably the same important process and key activities with the same focus and outcomes…..

  - **The auditor's objective remains the same**… *to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement [para. 11 of ISA 315 (revised 2019)]*

  - Understand the entity and its environment, the applicable financial reporting framework and the entity's system of internal control,

  - Identify risks of material misstatement; and

  - Assess risks of material misstatement.

  - *AUDIT RISK MODEL IS STILL THE SAME*

- Some refinements with the release of ISA 315 (revised 2019) however….

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ISA 315 (REVISED 2019)

○ Standard is effective for periods beginning on or after December 15, 2021

○ Changes to ISA 315 (revised) arose from stakeholder feedback, to include:

- 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 challenges of applying ISA 315 (Revised) when auditing small- and medium-sized entities (SMEs).

ISA 315 (REVISED 2019)

- Revision aims:
    - A more robust approach to risk identification and assessment result in better risk identification and improved compliance with ISA 330 and ISA 240.
    - Promote consistency in application of procedures for risk identification and assessment.
    - Make the standard more scalable through revised principles-based requirements.
    - Reduce the complexity and make the standard more usable by auditors of all entities, whatever the nature or complexity.
    - Support auditors using the standard by incorporating guidance material that recognizes the evolving environment, including in relation to information technology.

- Revisions focus on "what" needs to be done with improved application materials (AM) to describe the "why" and "how" procedures are to be undertaken.

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ISA 315 (REVISED 2019):
TOC WITH APPLICATION ETC. GUIDANCE

Risk assessment in the External Audit: 16/5/23

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ISA 315 (REVISED 2019):
DETAILED APPENDICES TO STD

Appendix 1: Considerations for Understanding the Entity and its Business Model

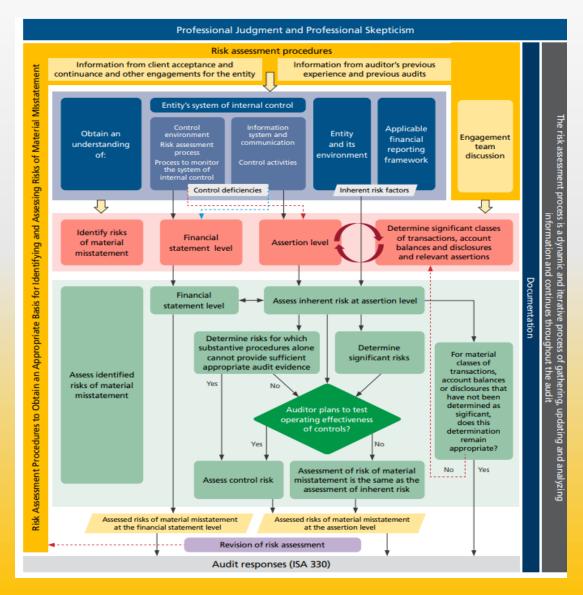Appendix 2: Understanding Inherent Risk Factors

Appendix 3: Understanding the Entity's System of Internal Control

Appendix 4: Considerations for Understanding an Entity's Internal Audit Function

Appendix 5: Considerations for Understanding Information Technology (IT)

Appendix 6: Considerations for Understanding General IT Controls

ISA 315 (REVISED 2019):
ITERATIVE PROCESS FLOWCHART

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ISA 315 (REVISED 2019):
SIGNIFICANT CHANGES

OBTAINING AN UNDERSTANDING

- Enhanced requirements relating to exercise of professional skepticism

- Clarification that the risk assessment process provides the basis for the identification and assessment of the risks of material misstatement, and the design of further audit procedures

- Separate focus on understanding the applicable financial reporting framework

The Entity's System of Internal Control

- Distinguishing nature of, and clarifying extent of, work needed for indirect and direct controls in the system of internal control

- Clarifying which controls need to be identified for purpose of evaluating the design of a control, and determining whether the control has been implemented (D&I)

ISA 315 (REVISED 2019): SIGNIFICANT CHANGES

OTHER ENHANCEMENTS

Scalability

- Principles-based requirements focused on 'what' needs to be done

- Application material highlights proportionality and scalability considerations under a separate heading, illustrating scaling up for more complex situations and scaling down for less complex situations

Using Technology in the Audit

- Considerations for using automated tools and techniques incorporated within the application material

- Supporting Q&A from IAASB's Technology Working Group

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ISA 315 (REVISED 2019): SIGNIFICANT CHANGES

IDENTIFYING AND ASSESSING RISK OF MATERIAL MISSTATEMENT

New Concepts and Definitions

'Significant classes of transactions, account balances and disclosures' and 'relevant assertions'	'Spectrum of inherent risk'	'Inherent Risk Factors'
to assist with the identification and assessment of the risks of material misstatement	to assist the auditor in making a judgment, based on the likelihood and magnitude of a possible misstatement, on a range from higher to lower, when assessing risks of material misstatement	to focus the auditor on the susceptibility of assertions to misstatement. These include: complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors.

ISA 315 (REVISED 2019): SIGNIFICANT CHANGES

RISK IDENTIFICATION AND ASSESSMENT

- Separate assessment of inherent risk and control risk

- Revised definition of *'significant risk'* for those risks close to the *upper end of the spectrum of risk*

- If the auditor does not contemplate testing the operating effectiveness of controls, the risk of material misstatement is the same as the assessment of inherent risk

OTHER CHANGES

- New 'stand-back' to evaluate the completeness of the significant classes of transactions, account balances and disclosures at the end of the risk assessment process

- Standard modernized and enhanced to include auditor considerations in relation to IT, including new and updated appendices for understanding IT and IT general controls

ISA 315 (REVISED 2019): SELECT KEY DEFINITIONS

- **Relevant assertions** – 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 any related controls (i.e., the inherent risk).

- **Significant class of transactions, account balance or disclosure** – A class of transactions, account balance or disclosure for which there is one or more relevant assertions.

- **Significant risk** – An identified risk of material misstatement: (i) 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 inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur; or (ii) That is to be treated as a significant risk in accordance with the requirements of other ISAs.1

ISA 315 (REVISED 2019): SELECT KEY DEFINITIONS

- **General information technology (IT) controls** – Controls over the entity's IT processes that support the continued proper operation of the IT environment, including the continued effective functioning of information processing controls and the integrity of information (i.e., the completeness, accuracy and validity of information) in the entity's information system. Also see the definition of IT environment.

- **Information processing controls** – Controls relating to the processing of information in IT applications or manual information processes in the entity's information system that directly address risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information).

ISA 315 (REVISED 2019): NEXT STEPS

- Get familiar with the full text of standard, especially AM and appendices.

- Exercise enhanced professional skepticism and judgement.

- Practice adequate documentation of work performed and positions arrived at.

- Refer to standards and seek feedback from fellow professionals.

REFERENCES:

- Fact Sheet: Introduction to ISA 315 (revised 2019) December 2019 .
- First time Implementation Guide ISA 315 (revised 2019) July 2022