ISA 315: Questions and answers from Livestream chat on 28 July 2021

1. Do you believe that we will record inherent risks for everything that can go wrong or result in RoMM without controls?

No, during the course I used the example of a credit note and a lack of segregation of duties. I specifically focused on revenue as an example because revenue is regarded as a presumed fraud risk. The auditor will thus be required to obtain an understanding of the information and communication system as well as the relevant control activities. The weakness in the control as explained triggered and identified risk of material misstatement.

A significant class of transactions, account balance or disclosure – A class of transactions, account balance or disclosure for which there are one or more relevant assertions. (ISA315.12(k))

Significant risk – 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 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
- That is to be treated as a significant risk following the requirements of other ISAs. (ISA315.12(l))

The auditor shall obtain an understanding of the entity's information system and communication relevant to the preparation of the financial statements, through performing risk assessment procedures, by:

- Understanding the entity's information processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances and disclosures:
- How information flows through the entity's information system, including how:
    - Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, incorporated in the general ledger and reported in the financial statements; and
    - Information about events and conditions, other than transactions, is captured, processed and disclosed in the financial statements;
- The accounting records, specific accounts in the financial statements and other supporting records relating to the flows of information in the information system;
- The financial reporting process used to prepare the entity's financial statements, including disclosures; and
- The entity's resources, including the IT environment

The auditor shall obtain an understanding of the control activities component, through performing risk assessment procedures, by:

- Identifying controls that address risks of material misstatement at the assertion level in the control activities component as follows:
    - Controls that address a risk that is determined to be a significant risk;
    - Controls over journal entries, including non-standard journal entries, used to record non-recurring, unusual transactions or adjustments;
    - Controls for which the auditor plans to test operating effectiveness in determining the nature, timing and extent of substantive testing, which shall

include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; and

- Other controls that the auditor considers are appropriate to enable the auditor to meet the objectives of paragraph 13 concerning risks at the assertion level, based on the auditor's professional judgment; (Ref: Para. A165)

The auditor's risk identification and assessment process is iterative and dynamic. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control are interdependent with concepts within the requirements to identify and assess the risks of material misstatement. (ISA315.7)

Inherent risk is described as the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

Control risk is described as the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's system of internal control.

Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud.

For the identified risks of material misstatement at the assertion level, a separate assessment of inherent risk and control risk is required

Inherent risk factors – Characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk. (ISA 315.12(f))

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 (ISA315.12(h))

Conclusion:

Inherent risk is based on the understanding of the entity and the circumstances specific to that entity. One can argue that without controls anything can go wrong, but that does not mean that it will cause a material misstatement for that specific client. There should be an indication from the circumstances of the client to indicate risk, and the possible outcome must be material.

To use another example, one can use cash on hand. There is always a risk that, without controls, cash may be stolen. However, this may not be an identified risk for all clients. Consider the following scenarios:

1. A client does not keep cash on hand at all – In this instance, NO risk will be identified;

2. A client keeps cash on hand, but it is a very small amount (immaterial) – even if there are absolutely no controls, and all the cash is stolen, it will not cause a material misstatement, and therefore, no risk of material misstatement;
3. A client keeps cash on hand, and the cash is material – There is a risk of material misstatement over the cash, which cause existence to be a relevant assertion, and cash to be a significant account balance. Now we can evaluate controls and possibly identify that they have controls in place to safeguard the cash.

2. Please confirm that ROMM is done per FSA item, e.g. Trade and other receivables, and not the sub-categories related to FSA item, for example VAT, Trade debtors and Sundries

Please refer to the SAICA FREQUENTLY ASKED QUESTIONS where the following was noted in point 3:

- Line items or individual financial statement items may be found in the separate statements that make up the financial statements and in the notes that form an integral part of the financial statements. In terms of the auditor obtaining reasonable assurance about the financial statements as a whole (ISA 200.11) (i.e. the complete set of financial statements), it would be appropriate for the auditor to use the notes (where applicable) to determine the relevant populations for purposes of selecting items for testing.

"Classes of transactions, account balances and disclosures" are interpreted as the line items making up, or the individual financial statement items presented in the separate statements and the notes in a complete set of financial statements.

Materiality in terms of testing each material financial statement item should be applied at the level of the individual financial statement items as presented in the separate statements and the notes.

Conclusion:

The standard requires a risk assessment to be performed per class of transaction, account balance and disclosure. As such the risk will be identified per line item in the financial statements. That being said, it may be that a sub-account within a line item, such as VAT, may have a different risk to the other accounts in the creditor's line item. In this instance, it will be important to document and assess that risk separately, as the response may need to be adjusted.

The same can be said for expenses. The risk assessment will be done for the expense line item as per the financial statements, however, if you as an auditor are aware of an individual expense with a different risk that may alter the response (e.g. legal expenses which may not be tax-deductible, general expenses that carry a risk of personal expenses being included, etc.) then these risks must be documented as well to ensure there are responses for them.

3.If the risk is the understatement of revenue, for cut off do we still start from inside the pot or outside the pot.

While obtaining audit evidence the auditor will determine the direction of testing. The direction of testing may either be from source documents to amounts reflected in financial statements balances or from financial statements to source documents. The appropriate direction will depend upon the purpose of a particular audit test. For the cut-off assertion, the auditor will always test from the financial statements to the source document.

4.I'm guessing we'll do this IR assessment and consideration of the 5 inherent risk factors per assertion too? Not for the line item but consider the 5 factors per assertion?

That is correct.

Inherent risk factors – Characteristics of events or conditions that affect susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance or disclosure, before consideration of controls. Such factors may be qualitative or quantitative, and include complexity, subjectivity, change, uncertainty or susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk. (ISA 315.12(f))

Conclusion:

Consideration of the inherent risk factors will be done per assertion for each class of transaction, account balance and disclosure.

5.When we consider these inherent factors, will we need to do this per individual expense as well, or consider general expenses as a whole?

Please refer to question 2 above

6. Does it mean that if there is not a relevant assertion we do not need to consider that assertion for testing?

Irrespective of the assessed ROMM, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure (ISA 330. 18)
Not all assertions within a material class of transactions, account balance or disclosure are required to be tested. Rather, in designing the substantive procedures to be performed, the auditor's consideration of the assertion(s) in which, if a misstatement were to occur, there is a reasonable possibility of the misstatement being material, may assist in identifying the appropriate nature, timing and extent of the procedures to be performed (ISA 330.A42(a))
Designing and performing further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level provide a clear linkage between the auditor's further audit procedures and the risk assessment. (ISA 330. A8)

For significant classes of transactions, account balances and disclosures, substantive procedures may have already been performed because paragraph 6 requires the auditor to design and perform further audit procedures that are responsive to the assessed risks of material misstatement at the assertion level. (ISA 330.A42)

Accordingly, substantive procedures are required to be designed and performed in accordance with paragraph 18:

- When the further audit procedures for significant classes of transactions, account balances or disclosures, designed and performed in accordance with paragraph 6, did not include substantive procedures; or
- For each class of transactions, account balance or disclosure that is not a significant class of transactions, account balance or disclosure, but that has been identified as material

This requirement reflects the facts that:

- The auditor’s assessment of risk is judgmental and so may not identify all risks of material misstatement; and
- There are inherent limitations to controls, including management override. (ISA 330. A42)

Further considered whether substantive procedures for all relevant assertions, for material classes of transactions, account balances or disclosures, in paragraph 18 of ISA 330 is required, but agreed that no further changes were needed beyond the proposed application material that makes it clear that the auditor would consider the most appropriate assertion when designing substantive audit procedures (Basis for conclusion par 69)

Conclusion:
If you have a significant class of transactions, account balance or disclosure, but not all the assertions are relevant (i.e. there are some assertions for which no risk was identified) you may not need to test those assertions.

For a class of transaction, account balance or disclosure for which there are no risks identified and as such no relevant assertions, you may not need to test all the assertions.

The auditor must however use their professional judgement to identify which of these assertions that are not relevant needs to be tested.

7. Will there be a case where you do not audit a balance at all if there is no relevant assertions. Or will you still audit at low risk level if the balance is more than materiality?

Irrespective of the assessed RoMM, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure (ISA 330. 18)

Not all assertions within a material class of transactions, account balance or disclosure are required to be tested. Rather, in designing the substantive procedures to be performed, the auditor’s consideration of the assertion(s) in which, if a misstatement were to occur, there is a reasonable possibility of the misstatement being material, may assist in identifying the appropriate nature, timing and extent of the procedures to be performed (ISA 330.A42(a))

The auditor need not design and perform further audit procedures where the assessment of the RoMM is below the acceptably low level (ISA 330. A4)

ISA 200:
P5: 5. As the basis for the auditor’s opinion, ISAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of
assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor’s opinion being persuasive rather than conclusive. (Ref: Para. A28–A52)

P13(e) Detection risk – The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements

P17 Sufficient Appropriate Audit Evidence and Audit Risk 17. To obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: Para. A28–A52)

PA31: Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. ISA 500 and other relevant ISAs establish additional requirements and provide further guidance applicable throughout the audit regarding the auditor's considerations in obtaining sufficient appropriate audit evidence.

P A36 Risks of material misstatement at the assertion level are assessed to determine the nature, timing and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk. Auditors use various approaches to accomplish the objective of assessing the risks of material misstatement. For example, the auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to
arrive at an acceptable level of detection risk. Some auditors find such a model to be useful when planning audit procedures.

Conclusion:

There may be classes of transactions, account balances and disclosures for which you will not identify or assess risks, and as such there will be no relevant assertions. This however does not mean that you do not have to test these items at all.

Where the value of the item is material, you will still be required to perform procedures. The nature and extent of these procedures will be based on professional judgement, the engagement risk, the detection risk and the auditor's evaluation of whether sufficient appropriate evidence was obtained.

8. Will completeness assertion not always have to be tested?

The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed RoMM at the assertion level (ISA 330.6)

Concerning material classes of transactions, account balances and disclosures, the application material now makes it clear that not all assertions within the material classes of transactions, account balances and disclosures are required to be tested (ISA 330.A42a). Rather, the auditor is required to identify the most appropriate assertion when designing substantive audit procedures.

These amendments clarify that the auditor is only required to design and perform further audit procedures on significant classes of transactions, account balances and disclosures (ISA 330.7) and material classes of transactions, account balances and disclosures (ISA 330.18). The further audit procedures to be performed must be responsive to the assessed risk, taking into account the reasons for the assessment given and ensuring that more persuasive audit evidence is obtained where a higher RoMM has been determined.

Conclusion:

The completeness assertion does not always have to be tested.

9. Can the spectrum of inherent risk be just "normal" or significant? Is it sufficient?

The degree to which inherent risk varies is referred to as the 'spectrum of inherent risk.'

Significant risk – An identified risk of material misstatement: (Ref: Para. A10)

- 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

The higher on the spectrum of inherent risk a risk is assessed, the more persuasive the audit evidence needs to be. (ISA 315.A125)

The auditor assesses the likelihood and magnitude of misstatement for identified risks of a material
misstatement because the significance of the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement where the misstatement to occur determines where on the spectrum of inherent risk the identified risk is assessed, which informs the auditor's design of further audit procedures to address the risk. (ISA 315.A205)

The assessed inherent risk relating to a particular risk of material misstatement at the assertion level represents a judgment within a range, from lower to higher, on the spectrum of inherent risk. The judgment about where in the range inherent risk is assessed may vary based on the nature, size and complexity of the entity, and takes into account the assessed likelihood and magnitude of the
misstatement and inherent risk factors. (ISA315.A209)

To develop appropriate strategies for responding to risks of material misstatement, the auditor may designate risks of material misstatement within categories along the spectrum of inherent risk, based on their assessment of inherent risk. These categories may be described in different ways. Regardless of the method of categorization used, the auditor's assessment of inherent risk is appropriate when the design and implementation of further audit procedures to address the identified risks of material misstatement at the assertion level is appropriately responsive to the assessment of inherent risk and the reasons for that assessment. (ISA315.A214)

Conclusion

The spectrum of inherent risk cannot just be Normal and Significant. Significant risks are risks that are at a higher end on the spectrum and as such classified as significant.

For these significant risks, the auditor must design a specific response. As such they will be tested sufficiently. For those left on the spectrum, the response must address the identified risk. The higher the risk the more extensive or persuasive the evidence must be.

This means that if you only classify risks as normal and significant, all risks that are not significant will be seen as normal, and the extent of procedures will not be amended to respond differently to a higher risk vs a lower risk. This may lead either to over auditing (auditing lower risk to a larger extent than necessary) or under auditing (auditing higher risks to a lower extent than necessary.)

10. I still don't fully understand this concept of significant classes of transactions etc.

Does it mean that we do not have to have a system description for example a balance that is above material but do not have a relevant assertion (significant risk)?

The auditor shall determine the relevant assertions and the related significant classes of transactions, account balances and disclosures. (ISA315.29)

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). (ISA315.12(h))

A significant class of transactions, account balance or disclosure – A class of transactions, account balance or disclosure for which there are one or more relevant assertions.

Example: Based on the auditor's understanding of the business, completeness of inventory has an identified RoMM. The relevant assertion would therefore be completeness and the significant account balance would be inventory.

The auditor's understanding of the entity and its environment and the applicable financial reporting framework may also assist the auditor in developing initial expectations about the classes of transactions, account balances and disclosures that may be significant classes of transactions, account balances and disclosures. These expected significant classes of transactions, account balances and disclosures form the basis for the scope of the auditor's understanding of the entity's information system. (ISA315.A49)

The auditor may use these initial expectations to determine the extent of understanding of the entity's information processing activities to be obtained. (ISA315.A126)

There may be classes of transactions, account balances or disclosures that are material but have not been determined to be significant classes of transactions, account balances or disclosures (i.e., there are no relevant assertions identified). (ISA315.A234)

These amendments clarify that the auditor is only required to design and perform further audit procedures on significant classes of transactions, account balances and disclosures (ISA 330.7) and material classes of transactions, account balances and disclosures (ISA 330.18).

Conclusion:

The extent of obtaining an understanding of control activities and the entity's information system is based on the auditor's expectation of significant classes of transactions, account balances and disclosures. As such if a line item is not identified as significant, i.e. no risks have been identified over that line item, then the auditor can decide not to obtain an understanding of the system description for that line item and not to document controls or perform walkthroughs.

11. Magnitude - does it mean if a transaction or balance is material the magnitude is always high?

Risk of Material Misstatement
For the ISAs, risk of material misstatement exists when there is a reasonable possibility of:

- A misstatement occurring (i.e., its likelihood); and
- Being material if it were to occur (i.e., its magnitude).

For inherent risk, significance may be considered in the context of how, and 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. (ISA 315.A10)

In assessing inherent risk, the auditor uses professional judgment in determining the significance of
the combination of the likelihood and magnitude of a misstatement. (ISA315.A208)

In considering the likelihood of a misstatement, the auditor considers the possibility that a misstatement may occur, based on consideration of the inherent risk factors. (ISA315.A210)

In considering the magnitude of a misstatement, the auditor considers the qualitative and quantitative aspects of the possible misstatement (i.e., misstatements in assertions about classes of transactions, account balances or disclosures may be judged to be material due to size, nature or circumstances). (ISA315.A211)

The higher the combination of likelihood and magnitude, the higher the assessment of inherent risk; the lower the combination of likelihood and magnitude, the lower the assessment of inherent risk. (ISA315.A212)

For a risk to be assessed as higher on the spectrum of inherent risk, it does not mean that both the
magnitude and likelihood need to be assessed as high. Rather, it is the intersection of the magnitude
and likelihood of the material misstatement on the spectrum of inherent risk that will determine whether the assessed inherent risk is higher or lower on the spectrum of inherent risk. A higher inherent risk assessment may also arise from different combinations of likelihood and magnitude, for example, a higher inherent risk assessment could result from a lower likelihood but a very high
magnitude. (ISA315.A213)

Conclusion:

In assessing risks, the magnitude refers to the possible misstatement that could arise from this error or fraud, and not the balance of the line item itself. Please note that when considering the magnitude, the qualitative impact of the possible misstatement must also be considered, not only the monetary impact.

12. If after Risk assessment, I have a pot that has no risk or not material, will that say my audit work will be little to none?

The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed RoMM at the assertion level (ISA 330.6)

The auditor need not design and perform further audit procedures where the assessment of the RoMM is below the acceptably low level (ISA 330. A4)

Conclusion:

There may be classes of transactions, account balances and disclosures for which you will not identify or assess risk, and as such there will be no relevant assertions. This however does not mean that you do not have to test these items at all.

Where the value of the item is material, you will still be required to perform procedures. The nature and extent of these procedures will be based on professional judgement, the engagement risk, the detection risk and the auditor's evaluation of whether sufficient appropriate evidence was obtained.

Where the value is immaterial, the auditor may decide to still perform basic procedures to ensure the amount should be immaterial, such as opening balance test, agree the amount back to the GL and underlying records, completeness procedures, etc. These will however be based on the professional judgement of the auditor.

13. Does auditor identify, evaluate and test implementation only for assertion(s) with significant risks and for which test of controls will be performed or all assertions related to relevant FSA?

The auditor shall obtain an understanding of the control activities component, through performing
risk assessment procedures, by:

- Identifying controls that address risks of material misstatement at the assertion level in the control activities component as follows:
    - Controls that address a risk that is determined to be a significant risk; (ISA315.26(a))

For each control identified:

- Evaluating whether the control is designed effectively to address the risk of material misstatement at the assertion level, or effectively designed to support the operation of other controls; and
- Determining whether the control has been implemented by performing procedures in addition to the inquiry of the entity's personnel. (ISA315.26(d))

The auditor's identification and evaluation of controls in the control activities component are focused on information processing controls, which are controls applied during the processing of information in the entity's information system that directly addresses risks to the integrity of information (i.e., the completeness, accuracy and validity of transactions and other information). However, the auditor is not required to identify and evaluate all information processing controls related to the entity's policies that define the flows of transactions and other aspects of the entity's information processing activities for the significant classes of transactions, account balances and disclosures.

Conclusion:

The auditor only needs to document controls and perform design and implementation tests for:

1. Controls over a significant risk
2. Controls that the auditor wants to perform TOC on to reduce inherent risks

Thus it is not necessary to document controls over assertions for which no risk was identified.

14. For test of controls, shouldn't 1 cycle be tested every year, with all cycles being tested within a 3 year period?

If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance and reliability of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit. The auditor shall obtain this evidence by performing inquiry combined with observation or inspection, to confirm the understanding of those specific controls, and:

- If there have been changes that affect the continuing relevance of the audit evidence from the previous audit, the auditor shall test the controls in the current audit.
- If there have not been such changes, the auditor shall test the controls at least once in every third audit and shall test some controls each audit to avoid the possibility of testing all the controls on which the auditor intends to rely in a single audit period with no testing of controls in the subsequent two audit periods.

If the auditor plans intend to rely test on controls over a risk the auditor has determined to be a significant risk, the auditor shall test those controls in the current period.

Conclusion:

For risk assessment purposes, a walkthrough must be performed each year. The three-year rule does not apply.

For test of control purposes, if there have been no changes to the entity or their internal control environment, the auditor can rely on the test of controls performed for 3 years before testing that specific control again. UNLESS the control is over a significant risk.

It is required to test some controls each year, rather than test them all in one year.

15. So we can have material balances/transactions with no testing after the stand back test?

For material classes of transactions, account balances or disclosures that have not been determined
to be significant classes of transactions, account balances or disclosures, the auditor shall evaluate
whether the auditor’s determination remains appropriate. (ISA315.36)

Materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances and disclosures. The auditor’s determination of materiality is a matter of professional judgment and is affected by the auditor’s perception of the financial information needs of users of the financial statements. For this ISA and paragraph 18 of ISA 330, classes of transactions, account balances or disclosures are material if omitting, misstating or obscuring information about them could reasonably be expected to influence the economic decisions of users taken based on the financial statements as a whole. (ISA315.A233)

There may be classes of transactions, account balances or disclosures that are material but have not been determined to be significant classes of transactions, account balances or disclosures (i.e., there are no relevant assertions identified). (ISA315.A234)

Audit procedures to address classes of transactions, account balances or disclosures that are material but are not determined to be significant are addressed in ISA 330.65 When a class of transactions, account balance or disclosure is determined to be significant the class of transactions, account balance or disclosure is also a material class of transactions, account balance or disclosure for paragraph 18 of ISA 330.

ISA 330 Paragraph 18 requires the auditor to design and perform substantive procedures for each material class of transactions, account balance, and disclosure, irrespective of the assessed risks of material misstatement.