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# FEEDBACK STATEMENT AND IMPACT ASSESSMENT:

## ISA (UK) 315 (Revised July 2020) Identifying and Assessing the Risks of Material Misstatement

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# FEEDBACK STATEMENT AND IMPACT ASSESSMENT

## ISA (UK) 315 (Revised July 2020) *Identifying and Assessing the Risks of Material Misstatement*

### Introduction

1. The Financial Reporting Council (FRC) is committed to acting as a proportionate and principles-based regulator, and balances the need to minimise the impact of regulatory requirements on business, while working to support the delivery of high-quality audit and assurance work, to maintain investor and wider stakeholder confidence in audit.
2. The International Standards on Auditing (UK) (ISAs (UK)) are based on the corresponding international standards issued by the International Auditing and Assurance Standards Board (IAASB). Where necessary, the international standards have been augmented with additional requirements to address specific UK legal and regulatory requirements; and additional guidance that is appropriate in the UK national legislative, cultural and business context.
3. On 19 December 2019, the IAASB issued ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement* and related conforming amendments to other ISAs. The effective date of the revised and amended standards is for audits of financial statements for accounting periods beginning on or after 15 December 2021.
4. The FRC strongly supports the revisions and related amendments, noting their importance in supporting a more robust and consistent risk identification and assessment. The FRC believes that they represent an improvement to the current standards and they are also designed to address concerns expressed by regulators and other stakeholders.
5. The FRC responded<sup>1</sup> to the IAASB's consultation on the revised standard, expressing its strong support for the aims of the IAASB. It identified several proposals the FRC was particularly supportive of and would want to be retained in the final standard. The response did not raise any significant concerns, but it did identify some areas where the FRC believed that the proposals could be further enhanced. The FRC is satisfied that the changes made by the IAASB in finalising the revised standard are appropriate and that ISA (UK) 315 (Revised June 2016) can be revised to adopt it without the need for further FRC supplementary material beyond the small amount currently included, in the form of two footnotes, which clarify who are 'those charged with governance' in a UK context and identifies they are the appropriate persons to provide critical written representations in line with ISA (UK) 580, *Written Representations*.
6. In January 2020 the FRC issued a public consultation on the proposal to revise ISA (UK) 315 (Revised June 2016) to adopt the revised international standard, retaining the small amount of current FRC supplementary material, and to make the related conforming amendments to other ISAs (UK). Our proposals ensure that the UK auditing standards

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<sup>1</sup> [https://www.frc.org.uk/getattachment/72175e81-948f-4aea-b232-3c11a9016d0c/FRC-Response-to-IAASB-Exposure-Draft-Proposed-ISA-315-Revised-\(Nov-2018\).pdf](https://www.frc.org.uk/getattachment/72175e81-948f-4aea-b232-3c11a9016d0c/FRC-Response-to-IAASB-Exposure-Draft-Proposed-ISA-315-Revised-(Nov-2018).pdf)

continue to be compliant with the ISAs and maintains the FRC's support for the international harmonisation of auditing standards based on ISAs.

7. The revision of ISA (UK) 315 includes:

- Modernising and updating the standard for an evolving business environment. This includes requiring the auditor to understand the entity's use of IT in its business, the related risks and the system of internal control addressing such risks. The related application material has also been significantly enhanced. There is a clearer delineation between the respective work efforts for understanding the IT environment, including information processing activities, as part of obtaining the understanding of the information system, and the requirements to identify and address risks of material misstatement arising from the use of IT related to the IT applications and other aspects of the IT environment.
- Taking account of the increasing use of automated tools and techniques by some auditors. There are no specific requirements to use these, reflecting that they are ways that procedures may be carried out but are not necessarily the only ways, but specific application material has been added to give examples of where and how they may be used.
- Provisions designed to enhance the use of professional scepticism throughout the risk assessment process, including:
  - Emphasising in the introductory paragraphs the importance of applying professional scepticism.
  - Emphasising the need to not bias the auditor's work toward obtaining evidence that is corroborative or excluding evidence that is contradictory.
  - Introducing a new requirement for the auditor, towards the end of the risk assessment process, to consider all audit evidence obtained from performing risk assessment procedures, whether corroborative or contradictory, (to evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement).
- Clarifying that the purpose of performing risk assessment procedures is to obtain audit evidence that provides an appropriate basis for the identification and assessment of the risks of material misstatement and the design of further audit procedures in accordance with ISA (UK) 330 (Revised July 2017) *The Auditor's responses to Assessed Risks*.
- Restructuring the requirement that focuses on the understanding of the entity and its environment, including to elevate the importance of understanding the applicable financial reporting framework.
- Including the concept of 'inherent risk factors' to assist the auditor in identifying events or conditions that may affect the susceptibility of assertions about classes of transactions, account balances or disclosures to misstatement.

- Enhancing and clarifying the requirements and application material pertaining to the auditor obtaining an understanding of the entity's system of internal control, including clarifying the controls for which the design is required to be evaluated and implementation determined. To aid understandability, the required understanding for each element of the system of internal control is presented in a tabular format.
- Enhancing and clarifying the requirements and application material pertaining to identifying and assessing the risks of material misstatement, including:
  - Introducing new concepts and/or definitions for:
    - Inherent risk factors (see above).
    - Relevant assertions - when the assertion about a class of transactions, account balance or disclosure has an identified risk of material misstatement.
    - Significant classes of transactions, account balances or disclosures – those for which there is one or more relevant assertions.
    - Spectrum of inherent risk – the degree to which inherent risk varies. Application material explains how this should be operationalised.
    - 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 in accordance with the requirements of other ISAs.
  - Explaining how control risk is assessed when the auditor does not plan to test the operating effectiveness of controls.
  - Introducing a stand-back requirement to drive the completeness of the identification of the risks of material misstatement by evaluating the completeness of the significant classes of transactions, account balances and disclosures identified by the auditor.
- Enhanced documentation requirements for the auditor's work in evaluating the design of controls and determining whether those controls have been implemented.
- Enhanced application material giving examples of areas that may be documented to help demonstrate the exercise of professional scepticism.

The revised standard is applicable to all audits and is designed to be scalable.

8. The other ISAs (UK) which are revised for the conforming amendments are:

ISA (UK) 200 (Revised June 2016) (Updated January 2020), *Overall objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*. Enhanced application material in relation to risks of material misstatement, including reference to inherent risk factors and the spectrum of inherent

risk. Added references to considerations in relation to scalability and automated tools and tools and techniques.

ISA (UK) 210 (Revised June 2016) (Updated July 2017), *Agreeing the Terms of Audit Engagements*. Minor conforming edits in the application material.

ISA (UK) 230 (Revised June 2016) (Updated January 2020), *Audit Documentation*. Clarifying that examples of matters that may be documented together in the audit of a smaller entity include the understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control.

ISA (UK) 240 (Revised June 2016) (Updated January 2020), *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*. Identifying that ISA (UK) 315 (Revised 2020) requires understanding of the applicable financial reporting framework and the system of internal control. Requiring that the auditor evaluate the design of controls that address risks of material misstatement due to fraud and determines whether they have been implemented. Requiring documentation of identified controls in the control activities component that address assessed risks of material misstatement due to fraud. Enhanced and edited application material, including for fraud risk factors.

ISA (UK) 250 Section A (Revised November 2019), *Consideration of Laws and Regulations in an Audit of Financial Statements*. Minor conforming edits in the application material.

ISA (UK) 260 (Revised November 2019), *Communication with Those Charged with Governance*. Minor conforming edits in the application material, including to conform references to matters that were determined to be 'significant risks' and to the entity's system of internal control.

ISA (UK) 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance*. Minor conforming edits, including to conform references to the entity's system of internal control.

ISA (UK) 300 (Revised June 2016), *Planning an Audit of Financial Statements*. Minor conforming edits in the application material.

ISA (UK) 330 (Revised July 2017), *The Auditor's responses to Assessed Risks*. Conforming edits and enhancements to the requirements and application material. These include clarifying that the auditor need not design and perform further audit procedures where the assessment of the risk of material misstatement is below the acceptably low level; enhanced application material in relation to general IT controls; enhanced application material in relation to when substantive procedures are required to be designed and performed.

ISA (UK) 402, *Audit Considerations Relating to an Entity Using a Service Organization*. Enhanced and clarified description of the scope of the standard. Enhanced and clarified objective. Conformed references to controls, and requiring that the auditor evaluate the design of controls in the controls activities component and determine whether they have been implemented. Conforming edits to the application material.

ISA (UK) 500 (Updated January 2020), *Audit Evidence*. Minor conforming edits in the application material.

ISA (UK) 501, *Audit Evidence—Special Considerations for Selected Items*. Minor conforming edits in the application material.

ISA (UK) 530, *Audit Documentation*. Minor conforming edits in the application material.

ISA (UK) 540 (Revised December 2018), *Auditing Accounting Estimates and Related Disclosures*. Conforming edits in the requirements and application material, including in relation to references to the applicable financial reporting framework, inherent risk factors, the entity's information system, controls and IT applications.

ISA (UK) 550, *Related Parties*. Minor conforming edits in the application material.

ISA (UK) 600 (Revised November 2019), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. Minor conforming edits in the requirements and application material, including to refer to understanding the applicable financial reporting framework and system of internal control.

ISA (UK) 610 (Revised June 2013), *Using the Work of Internal Auditors*. Minor conforming edits, including to refer to understanding the applicable financial reporting framework and system of internal control. Identifying that significant risks are risks assessed close to the upper end of the spectrum of inherent risk.

ISA (UK) 620 (Revised November 2019), *Using the Work of an Auditor's Expert*. Minor conforming edits in the application material.

ISA (UK) 701 (Revised November 2019) (Updated January 2020), *Communicating Key Audit Matters in the Independent Auditor's Report*. Conforming edit in the application material to identify that a significant risk is 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 the 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 (UK) 720 (Revised November 2019), *The Auditor's Responsibilities Relating to Other Information*. Minor conforming edits in the application material relating to matters the auditor obtains an understanding of in line with ISA (UK) 315 (Revised July 2020).

9. The FRC's consultation closed on 3 April 2020. We received 11 responses – five from professional bodies, five from audit firms and a joint response from two organisations representing the interests of shareholders, which are listed in the Appendix to this Statement<sup>2</sup>. Our expectation was that comments would be limited given the existing general support for FRC's long standing position on ensuring UK auditing standards are compliant with the ISAs; and that the FRC was not proposing substantive modifications to the requirements and application material in the revised international standard nor proposing further substantive FRC supplementary material.

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<sup>2</sup> Copies of the responses can be seen at: [https://www.frc.org.uk/consultation-list/2020/proposal-to-revise-isa-\(uk\)-315-\(revised-june-2016\)](https://www.frc.org.uk/consultation-list/2020/proposal-to-revise-isa-(uk)-315-(revised-june-2016))

10. A summary of the responses received to the specific questions asked in the consultation, and the FRC's response, are set out below.

*Q1. Do you agree that ISA (UK) 315 (Revised June 2016) and other ISAs (UK) should be revised to adopt the revisions to the underlying international standard and the related conforming amendments to other ISAs? If not, please give your reasons and explain what action, if any, that you believe should be taken to update the ISAs (UK) in relation to identifying and assessing the risks of material misstatement.*

### **Summary of Responses**

All respondents agreed the proposed adoption of the revisions. Three audit firms identified that they had expressed some concerns to the IAASB about complexity and scalability in some areas when the international standard was revised and did not consider that they had been fully addressed by the IAASB. It was not suggested that these concerns were sufficient to cause the FRC not to adopt the revisions, but we were encouraged to provide implementation support.

### **FRC Response**

The FRC does not propose to make further changes to the standard. The IAASB has recognized that support for those initially applying the changes to ISA 315 (Revised) is critical and it will further consider the most appropriate actions in providing this initial support. We will monitor and contribute where possible and appropriate to the IAASB's implementation support initiatives.

*Q2. If you agree that the ISAs (UK) should be revised to adopt the revised ISA 315 and conforming amendments, do you agree that the UK supplementary material can be limited to that shown in the exposure draft? If not, please give your reasons and explain what supplementary material, if any, you believe should be added.*

### **Summary of Responses**

All respondents agreed maintaining the extant supplementary guidance. Three respondents (two professional bodies and one audit firm) suggested that further implementation guidance and support outside of the revised standard would be helpful. One audit firm suggested that it would be helpful to include worked examples in the standard. The shareholder representatives suggested that, in light of the Brydon Report, the FRC should consider his recommendation of including the concept of professional suspicion into auditing in addition to enhancing professional scepticism.

### **FRC Response**

Neither the IAASB nor FRC include worked examples of audit approaches within standards. They cannot cover all situations and it is generally recognised that such examples are, where considered appropriate, better given in publications outside of the standards. As noted above, the FRC will monitor and contribute where possible and appropriate to the IAASB's implementation support initiatives.

The revisions to the standard include provisions designed to enhance the use of professional scepticism throughout the risk assessment process. The FRC will be giving due consideration to Sir Donald Brydon's recommendations. It is, however, not considered to appropriate to reopen the revision of ISA (UK) 315 at this stage to consider the inclusion of the concept of



professional suspicion as that would inevitably lead to a significant delay in finalising the standard and implementing the other intended benefits of the revision.

*Q3. Is the proposed effective date (audits of financial statements for accounting periods beginning on or after 15 December 2021), which is consistent with the effective date of the IAASB's revised ISAs, appropriate? If not, please give reasons and indicate the effective date that you would consider appropriate.*

### **Summary of Responses**

Ten respondents (the professional bodies and audit firms) agreed the proposed effective date. Of those, one professional body and one audit firm conditioned their responses on there being adequate implementation support. The shareholder representatives said they believed a more appropriate date would be accounting periods beginning on or after 1st January 2021 (or 15th December 2020). They feel the date proposed in the consultation sends an implied message that this is a matter of secondary importance for which a leisurely approach to implementation is acceptable.

### **FRC Response**

The FRC does not propose to change the effective date of the revised ISA (UK) 315. The proposed effective date was set having regard to the fact that the revisions introduce significant changes that firms will have to reflect in their methodologies and also develop and deliver training to staff. However, early implementation will be permitted.

## **Impact Assessment**

As a matter of policy, the FRC's auditing standards are based on the corresponding international standards issued by the IAASB. Where necessary the international standards are augmented with additional requirements to address specific UK legal and regulatory requirements; and additional guidance that is appropriate in the UK national legislative, cultural and business context. We believe that ISA (UK) 315 (Revised July 2020) introduces changes that are appropriate and proportionate to address issues that have been identified since the current standard was issued.

We have maintained the FRC's supplementary footnotes from the current standard, which clarify who are 'those charged with governance' in a UK context and identifies they are the appropriate persons to provide critical written representations in line with ISA (UK) 580, *Written Representations*. This should not result in additional work effort compared to the underlying international standard.

The revised standard has been designed to be scalable. We believe that benefits in the public interest of enhancements to the quality of audit through a more robust and consistent risk identification and assessment, although not quantifiable, will outweigh the costs of changes that may be necessary to audit firms' methodologies.

**Financial Reporting Council**

**July 2020**

**Respondents to the consultation on the proposed revision of ISA (UK) 315**

**Professional Bodies**

ACCA

Chartered Accountants Ireland

CPA Ireland

ICAEW

ICAS

**Audit Firms**

Grant Thornton UK LLP

KPMG LLP

Kreston Reeves LLP

Mazars LLP

PwC LLP

**Other**

ShareSoc and UKSA (joint response)



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