

ISA 315: Identifying and Assessing the Risks of Material Misstatement



ISA (UK) 315 (Revised July 2020) will be effective for financial statement audits for periods beginning on or after 15 December 2021. Typically this will be applicable for entities with a yearend of 31 December 2022 onwards.

The standard was rewritten in response to some high-profile audit failures and has been revised with an aim to improve audit quality. The FRC consider the new standard to improve significantly on the old version and is better designed to “meet the challenges of an evolving business environment and the needs of users and protect the public interest.”

The effects of the revisions will be far-reaching. The ISA itself has increased from 32 to 38 requirements and includes more than 90 pages of application guidance, illustrating that the revisions are comprehensive and will require all auditors to significantly revise their audit approach. Below are a summary of just a few of the key changes that affect us as auditors and the impact this will have on your to your annual audit:

CHANGES FOR AUDITORS

- The introduction of five new inherent risk factors to aid in risk assessment; subjectivity, complexity, uncertainty, change and susceptibility to misstatement due to management bias or fraud.
- A new “spectrum of risk”, at the higher end of which lie significant risks.
- Requiring “sufficient, appropriate” evidence to be obtained from risk assessment procedures as the basis for the risk assessment.
- A great deal more on controls, distinguishing between direct and indirect control components and particularly IT general controls.
- Removal of considerations specific to smaller entities.
- Requiring inherent and control risk to be assessed separately;
- A new stand-back requiring reconsideration, when material classes of transactions, account balance and disclosure are not assessed as significant.

CHANGES TO YOUR AUDIT

The ‘inherent risk spectrum’ involves a more judgmental consideration of risks. We will plot the potential magnitude of a misstatement against its likelihood, to determine where on this spectrum an inherent risk sits. Where a risk falls on this spectrum will determine the extent of further procedures we will need to perform. As a result you will find that we will ask you for greater quantities of audit evidence during the audit process.

We must revise our understanding and seek deeper insights about the key controls in place at the business including its IT control environment. Our teams will spend more time completing risk assessment processes, performing more detailed planning and walkthrough testing and will make new detailed enquiries to management, operations, and IT teams in order to identify where these controls (or lack of) give rise to further risks.

Removal of considerations specific to smaller entities means the ISA is the same for all sizes of entities. It has been replaced with a concept of ‘scalability’ which requires us to determine how complex an entity is and tailor our work accordingly, requiring significantly more judgement from us as auditors.

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CONCLUSION

Although we welcome these changes as an effort to enhance audit quality, the new requirements will significantly increase the amount of time we will spend on your audit. How much will depend on the scale and complexity of your business, the risks it faces and your control and IT environment.

Due to this differing level of impact on different entities, it will be hard to make generalisations about the likely impact on audit fees, but we estimate that they will rise by between 5 - 20% to meet the new requirements imposed on us by the new ISA (UK) 315.

As well as increasing audit quality, we also expect that through the changes to our audit approach and the deeper understanding we will gain of your business and its systems as a result, we will be better placed than ever to provide insight into control weaknesses and recommend improvements.

If you are concerned about the changes outlined above or the change in your expected audit fee please contact your engagement partner as soon as possible to discuss.