ISA 315: Putting the building blocks together

Impressions and lessons learned from first adoption

6 December 2023

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Today's presenters

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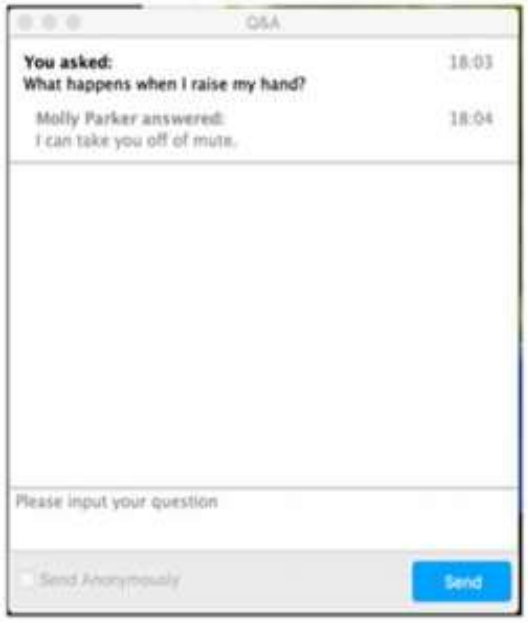
Ask a question



To ask a question

Click on the **Q&A** button in the bottom toolbar to open the submit question prompt.

Type your question and click send

NOTE: If you wish to ask your question anonymously check the **send anonymously** box shown on the illustration.

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Did you know?

From 1 November 2023, ICAEW's revised Continuing Professional Development (CPD) Regulations brought in new CPD requirements, including a minimum number of hours and an ethics requirement.

This webinar could contribute to up to 1 1/2 hours of verifiable CPD, so long as you can demonstrate that the content is relevant to your role.

Find out more about how these changes affect you at icaew.com/cpdchanges.

Contents

Introduction

ISA 315 Survey Feedback

Recap & Reality Check

Scepticism & Relevance of the Business Model

Controls, IT and GITC

Risk Assessment – Supporting an effective audit response

Testing Strategy & Sample Sizes

Documentation & Evidence

Implementation cost - Opportunities

Planning: Maximising impact and return

Q&A

To be complemented by future ICAEW material

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Survey feedback

"With the 2023 reporting season coming to a close it would be helpful to have your feedback on your experience of applying the new ISAs, principally ISA 315 (but also ISA 220 and ISA 240):"

- **Which areas of the new ISAs did you find most difficult to apply and why?**
- **Which areas of the new ISAs made the greatest positive difference to your audit and why?**
- **Which areas of the new ISAs would you value training and or clarification on and why?**

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"And, our survey said…..:

Areas of the new ISAs made the greatest positive difference to your audit and why?

- Focusing on risk assessment and controls evaluation - encouraged more detailed planning and better understanding of our clients.
- A more focused approach to risk assessment, leading to better audit quality.
- Lead to a deeper understanding of clients and their business models, which helps in risk profiling.
- Greater emphasis on assertion-level planning and risk assessment, ensuring a more efficient and effective audit overall.
- Better appreciation of fraud risk factors and opportunities.
- Better team collaboration and sharing of knowledge.

Areas of the new ISAs you found most difficult to apply.

+

Areas of the new ISAs where you would you value training and or clarification.

- Complexity in assessing inherent risk
- Determining what is a significant risk
- Justification of risk assessment
- Is it really scalable…..how do we develop an acceptable proportionate response for smaller OMBs
- Impact on sample sizes
- Fraud risk assessment and discussing this sensitive areas
- **Can we have some templates!**
- **Control evaluation**
- **IT and GITC evaluation**
- ***"We have done all of this, and it has made no difference to our audit, accept add cost – what is the point"***

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Drivers of Change

Formal

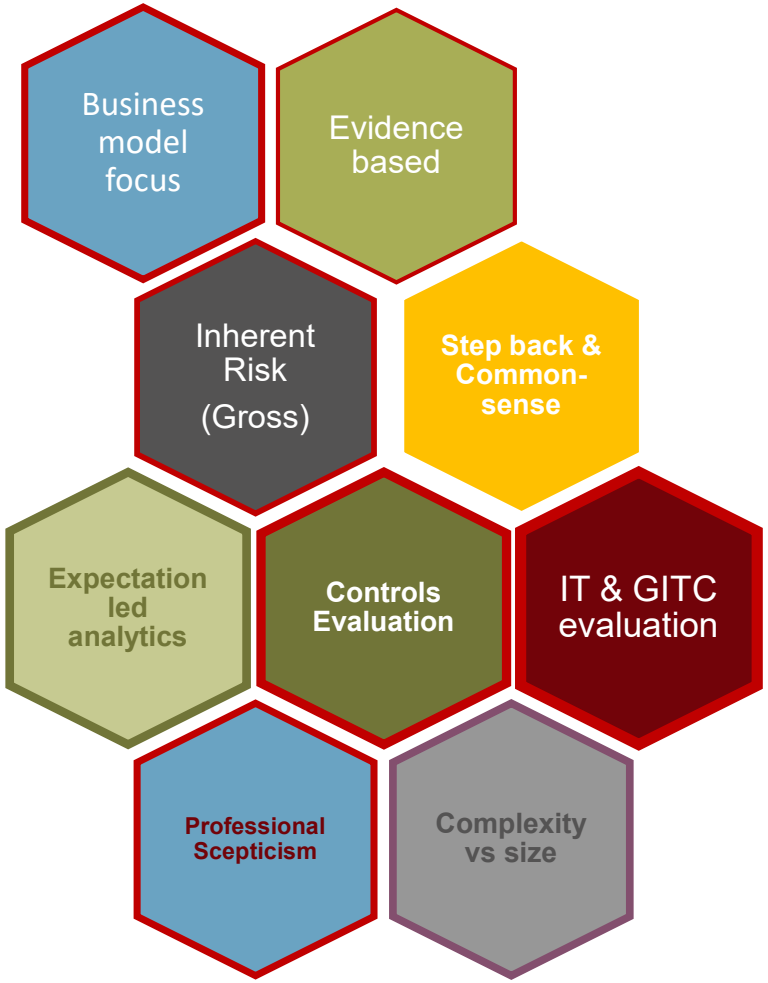
ISA 315 Implementation Monitoring Project (Completed in 2013)

- Inconsistency over ***significant risks*** identified.
- Practical application of obtaining an understanding of the ***system of internal control***.
- Insufficient guidance in respect of ***IT*** risks.
- ***Scalability*** concerns for SME audits.

Informal

RCA other anecdotal findings

- Relevant sector knowledge?
- Responding ("in flight") to new information and changes in risk.
- Sufficient expectation led scepticism and challenge?



Getting into the scepticism zone

- *Why the focus on the entity and the environment*
- *Mindset*
- *Fraud*

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Why the focus on the entity & the environment

Influences	Business Eco-system	Behaviours	So what!
• Price of inputs and outputs • Laws and regulations • Business practice	Sector & Economy	Correct Starting Point	• Key knowledge to promote scepticism & challenge • NoCLAR Obligations. • Climate change and ESG disclosures • Management pressures and behaviour drivers
• Route to market • Complexity of offering • Pricing structure • Critical resources • Use of IT	Business model	Decreasing Control / Increasing Risk of Bias	Fundamental to: • risk assessment and "what could go wrong" • Fraud evaluation and "what could go wrong" • Providing context to the management information • Understanding data flows and Test design • Evaluating resources including the use of experts
• Stakeholder expectations • Debt – covenants and headroom • Friends & Family	Funding		
	Accounting framework	Typical Starting Point?!?	Fundamental to: • Risk assessment • Going concern • Opportunity, incentives and motivation
• IFRS v Local GAAP – Framework hopping			
• Revenue recognition • Financial instruments • Impairments, depreciation & amortisation. • Actual and contingent liabilities etc.	Judgement & Estimation		Fundamental to: • Identifying key estimates and judgements • Key assertions relating to transactions, balances ***and disclosures*** • Opportunity, incentives and motivation *(e.g. accounting policy choices)*
	Stakeholder Requirements	Rewards Model	Fundamental to stakeholder and public interest obligation

Where is our head when we are auditing?

Are we:

A. Looking at evidence provided to us to confirm management's position?

B. Independently and objectively seeking evidence that has equal probability of corroborating or disproving assertions made by management?

Requires robust understanding of the entity we have been engaged to audit and the environment in which it operates (and reports).

Allows for the application of professional scepticism and constructive challenge.

Supports effective and valued engagement with management and TcwG.

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Fraud – An uncomfortable truth

- Understand the entity, the environment and a range of sector norms
- Get in touch with your dark side and think what could go wrong – if I really wanted to, how could I?
  - ❖ CSI Audit – Motive, Opportunity, Pressure
  - ❖ Articulate and set expectations – what might a fraud look like?
  - ❖ Partner led team and client discussion – what could go wrong?
- Talk to people outside of the finance function
- Open questions of TcwG and Management on fraud risks and how the mitigate the risk.

ISA 240 requires the auditor to be alert to more sophisticated fraud *"a series of transactions and balances which individually are below materiality but together and cumulatively over time are material!"*

What about those sample differences and other anomalies dismissed as "isolated".

Threats

Bank Covenants
Bonuses and other incentives
Laws and regs critical to continued operation
Unusual variances
Suspense accounts and control variances
Organised Chaos - Just in time delivery!

Difficult discussions don't need to be difficult – Aligned with exceptional client service.

Avoid closed questions and checklists

Controls, IT & GITC

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Poll 1

Do you regularly use online banking or an ecommerce provider such as Amazon, Ebay or, buy plane or train tickets online?

◯ Yes ◯ No ◯ Not Applicable – I rely on the barter economy

Do you have a password to log into your work server/computer and does your firm/IT support company require that you either change your password regularly or use some form of two factor authentication?

◯ Yes ◯ No ◯ Not applicable

Controls, IT and GITC Evaluation

"Why bother, we just do substantive testing?"

- More focused testing allowing better utilisation of precious resource
- Audit response is targeted on real world risks not theoretical/generic risks
- Informs you about the likely quality of information being presented for audit and the integrity of management
- May allow the utilisation of other audit techniques
- Staff attraction and retention
- Client attraction and retention

Areas where substantive testing alone may not be sufficient

Essential to:

- Anchor the results of testing
- Evaluate the nature and incidence of any errors detected

Why wouldn't you! –
It is good for business and good for assurance.

Express ISA Requirement

What Controls, IT and GITC do you need to evaluate

The overall Control and IT "*Environment*" - Holistic

Required Design & Implementation Evaluation (D&I) – Assertion level (mostly)

Controls, procedures and IT applications and that relate to:

(i) Identified significant risks (and KAMs);

(ii) Journal entries;

(iii) Those that the auditor plans to test operating effectiveness in determining the nature, timing and extent of substantive testing (***e.g. those risk areas where for which substantive procedures alone do not provide sufficient appropriate audit evidence***);

(iv) Identified fraud risks; and,

(v) Those which in the auditor's professional judgement should be tested to meet the requirements of ISA 330.

Not a Controls and IT resilience audit.

Not a hackathon or disaster recovery test!

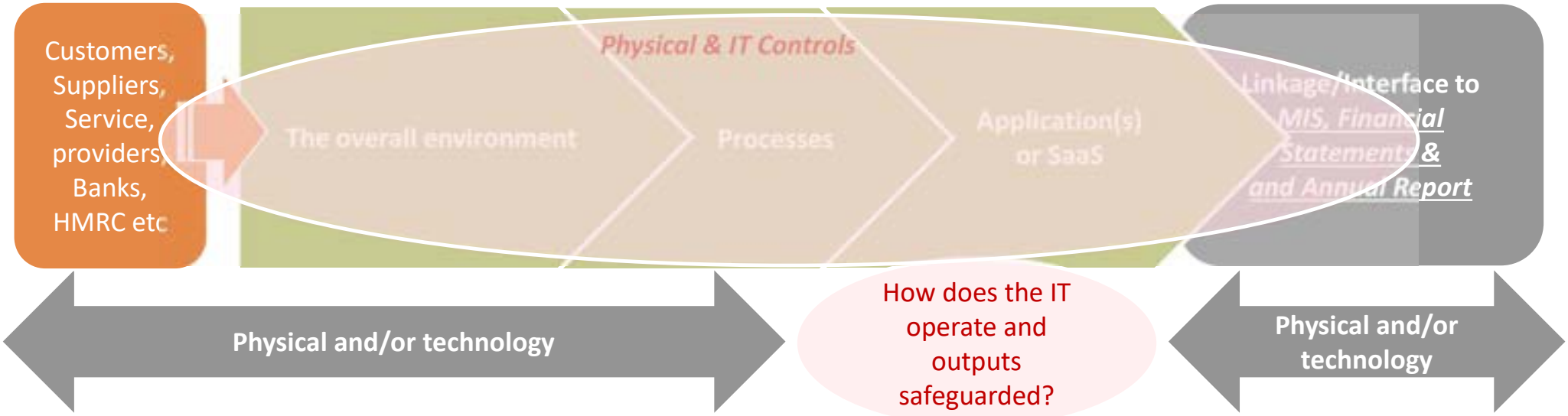
Focused on the assertion level risks that are relevant to a financial statement audit.

Not just about IT – Manual Process and Controls may form part of the IT environment

But…..
Has to be done regardless of a purely substantive audit?

Not as daunting as it may seem as there is a lot of common sense and every day experience we can all draw on.

What! – Where do we start and what is covered?



Potentially daunting?

But….We all have plenty of experience and common sense to draw on for most scenarios:
Logging in to our practice network, online banking, online shopping, managing our online data and profile, TFA etc etc

Don't get blind sided by jargon and techspeak. Keep it simple:

- What is the origin of each £1 in the annual report, where did it come from;
- How did it get there;
- What (could have) happened to it on the way;
- How was its journey safeguarded; and,
- Don't be seduced by the "simplicity" of spreadsheets and similar.

Watch out for "end user application"
(e.g. Spreadsheets – GC, FV, Impairment, Consolidation, Options … ion of the financi s)

Poll 2

A company has several products and service lines which it sells through a combination of trade outlets and via its website.

Products are comprised bought in part completed components which are reworked and assembled and are costed based on materials and absorbed time cost which is tracked on a specially developed stock costing system accessible by finance and the warehouse

Once completed they are stored at a third-party warehouse and logistics hub who deal with distribution who provide real time data to the finance team.

Payroll is outsourced to a well-known specialist provider alongside HR.

The company uses Sage as its core accounting package.

The finance team are based in a different location to production and sales.

- ◯ Non-complex
- ◯ Moderately Complex
- ◯ Complex
- ◯ Need more info to conclude

Poll 3

A company is a regional double glazing supplier and installer whose customers include both commercial and domestic buyers.

Quotes are prepared manually, but once confirmed are uploaded into a work scheduler tool. The tool produces a weekly report on completed jobs which are then invoiced.

The company has both employed and subcontract labour.

The company has a small finance team, so it has out-sourced its payroll to a local bureau. The company uses Xero as its accounting package.

- ◯ Non-complex
- ◯ Moderately Complex
- ◯ Complex
- ◯ Need more info to conclude

Proportionality and Complexity

	Examples of typical environments		
	Non-complex commercial Software	Mid-size and moderately complex commercial software or IT applications	Large or complex IT applications (e.g. ERP systems)
Extent of automation & Use of data	• Simple • Manual inputs • No interfaces • Low data volumes • Local data	• Simple • Small number of inputs and interfaces • Low data volumes or medium volumes of simple data • Local data	• Extensive & complex • Highly automated & multiple interfaces • Large and complex data sets
Type of application and infrastructure	• Purchased off the shelf • Outsourced/cloud • No emerging tech	• Purchased off the shelf or simple low end ERP • Limited customisation • Outsourced/cloud • Limited emerging tech	• Complex • Customised • Large infrastructure • Web-facing • Mixed use of emerging tech
IT Processes	• Simple • Small teams • No source code • Few or no changes • Vendor led updates	Increasing team size and complexity	Very Complex

May not need an IT specialist

Greater likelihood of needing to involve an IT specialist

The greater the volume of data and complexity of the system, be alert to those instances where substantive testing alone may not be sufficient.

- Not just about IT - Can include manual processes and controls.
- Key is understanding how data originates and flows through to the financial statements.
- Understand what could go wrong

Non-complex does not mean you don't need to follow ISA 315 and default to a black box substantive- based approach.

Acknowledgement: FRC ISA 315 Extract and simplification

Typical GITCs

The nature of the general IT controls typically implemented for each of the aspects of the IT environment:

Application Controls

Will correlate to the nature and extent of application functionality and the access paths allowed in the technology. For example, more controls will be relevant for highly-integrated IT applications with complex security options than a legacy IT application supporting a small number of account balances with access methods only through transactions.

Database Controls

Typically address risks arising from the use of IT related to unauthorized updates to financial reporting information in the database through direct database access or execution of a script or program.

Operating System Controls

Typically address risks arising from the use of IT related to administrative access, which can facilitate the override of other controls. This includes actions such as compromising other user's credentials, adding new, unauthorized users, loading malware or executing scripts or other unauthorized programs.

Network Controls

Seek to address risks arising from the use of IT related to network segmentation, remote access, and authentication. Network controls may be relevant when an entity has web-facing applications used in financial reporting. Network controls are also may be relevant when the entity has significant business partner relationships or third-party outsourcing, which may increase data transmissions and the need for remote access.

- Relevant to all businesses
- Scalable
- Less observable in small non-complex OMB
- Challenges of SaaS

What happens at your firm – how do you access your network and Apps?

Inquire – Observe – Understand – Challenge – Confirm – Evidence
Tailor to be relevant of a Financial Statement Audit

Extracted from: ISA (UK) 315 (Revised) July 2020

What & How

- Those areas relevant to a financial statement audit!
- Understand – Inquire - Observe - Challenge- Confirm - Evidence

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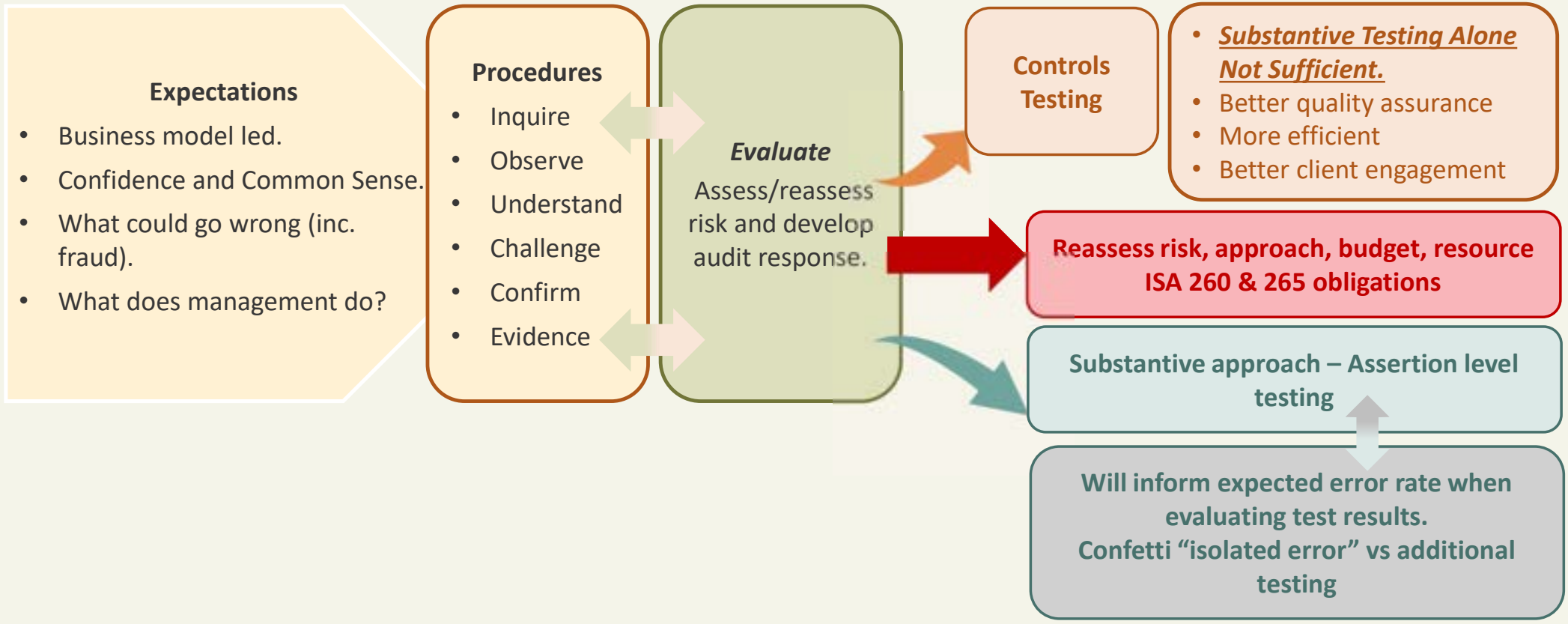
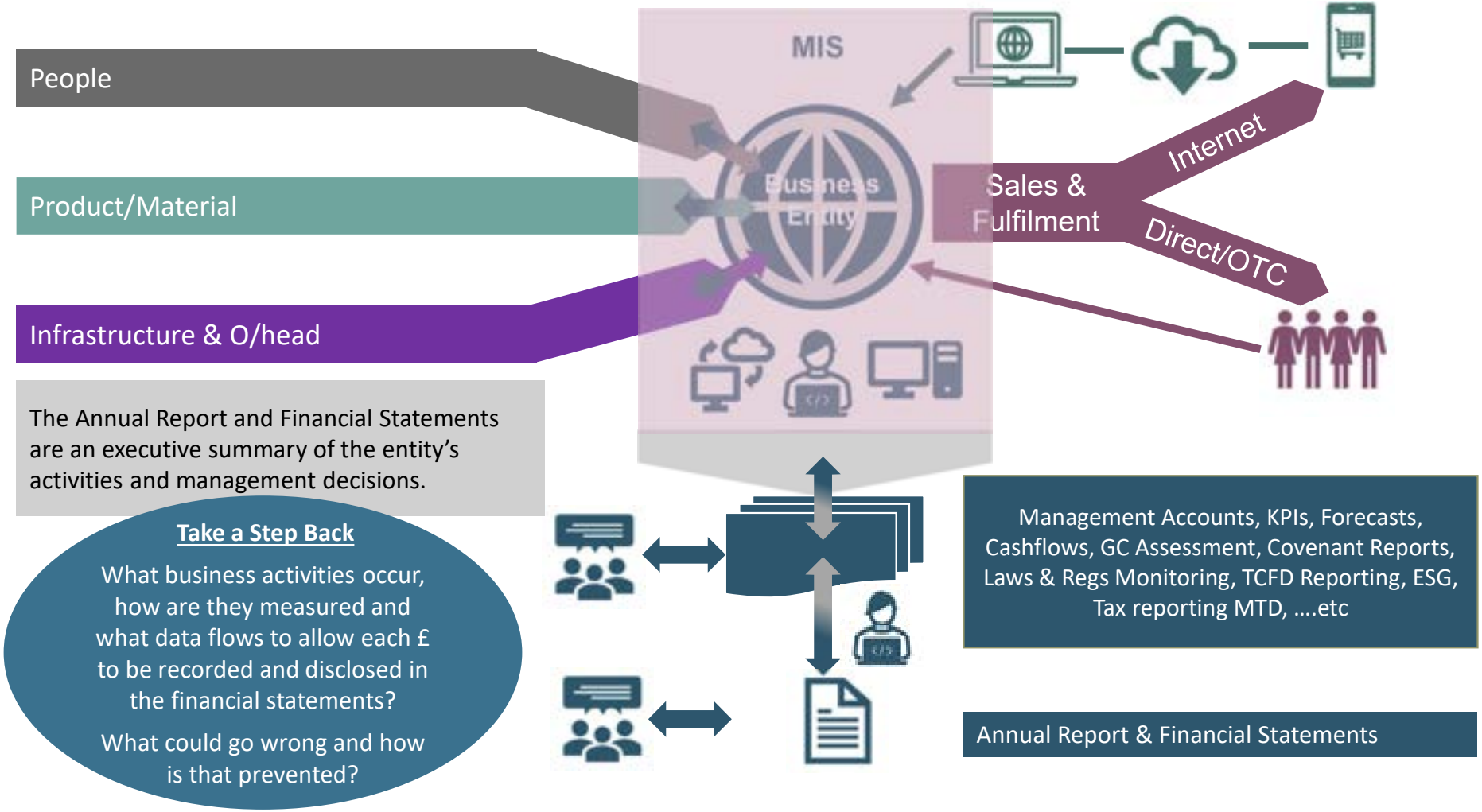
Controls & IT Evaluation - How

Design & Implementation → **Operation & Effectiveness Testing**



IT – Follow the Business Model



People Costs

HR

- Hires & Fires
- Hours and Overtime
- Pay rates
- Productivity
- Performance & evaluation
- Laws and regulations

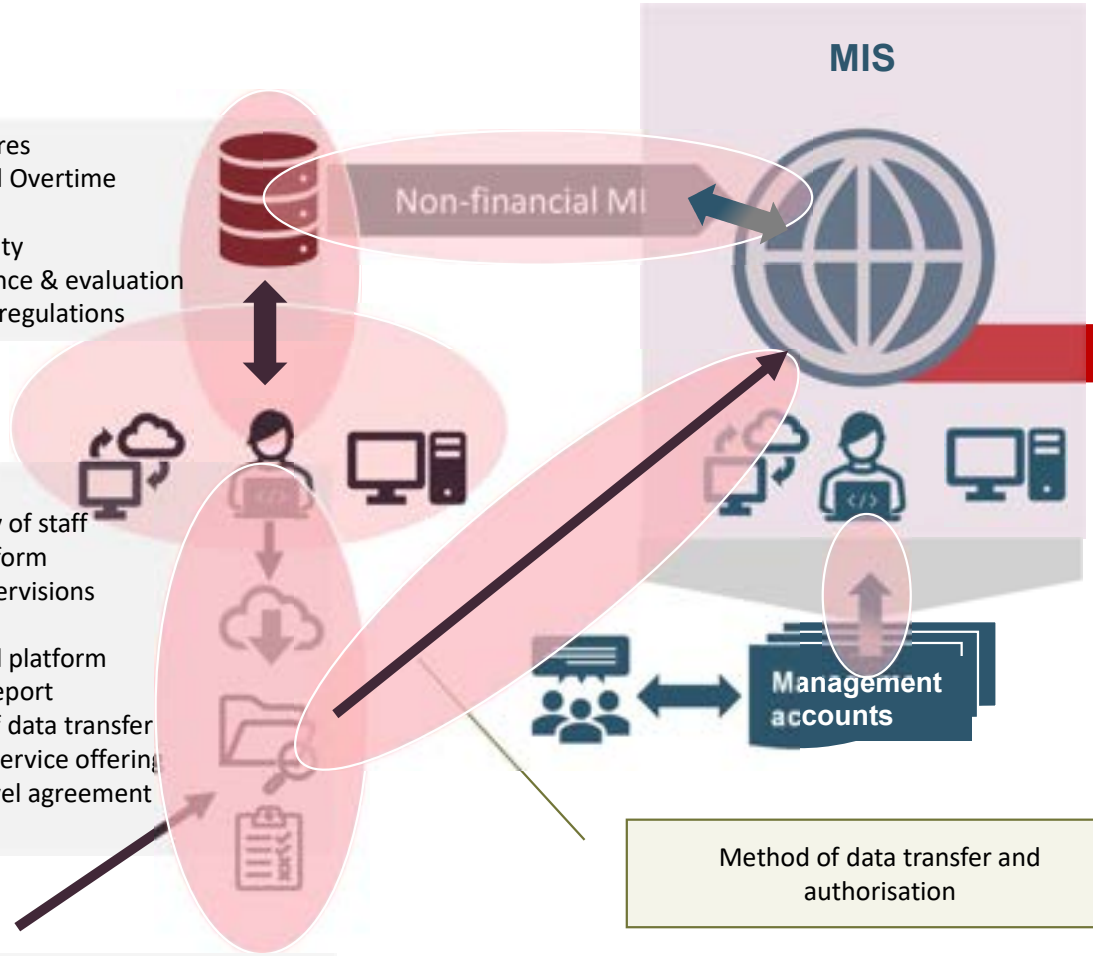
Payroll

Inhouse
- Competency of staff
- Type of platform
- Level of supervisions

Outsourced
- Accredited platform
- Controls report
- Method of data transfer
- Extent of service offering
- Service level agreement
- Oversight

Finance

Cross check, approval, data transfer and payment run



Key GITC Considerations

- What format is the database?
- Who has access?
- Access security?
- Data transfer security?
- Change and access log?
- Change authorisation?

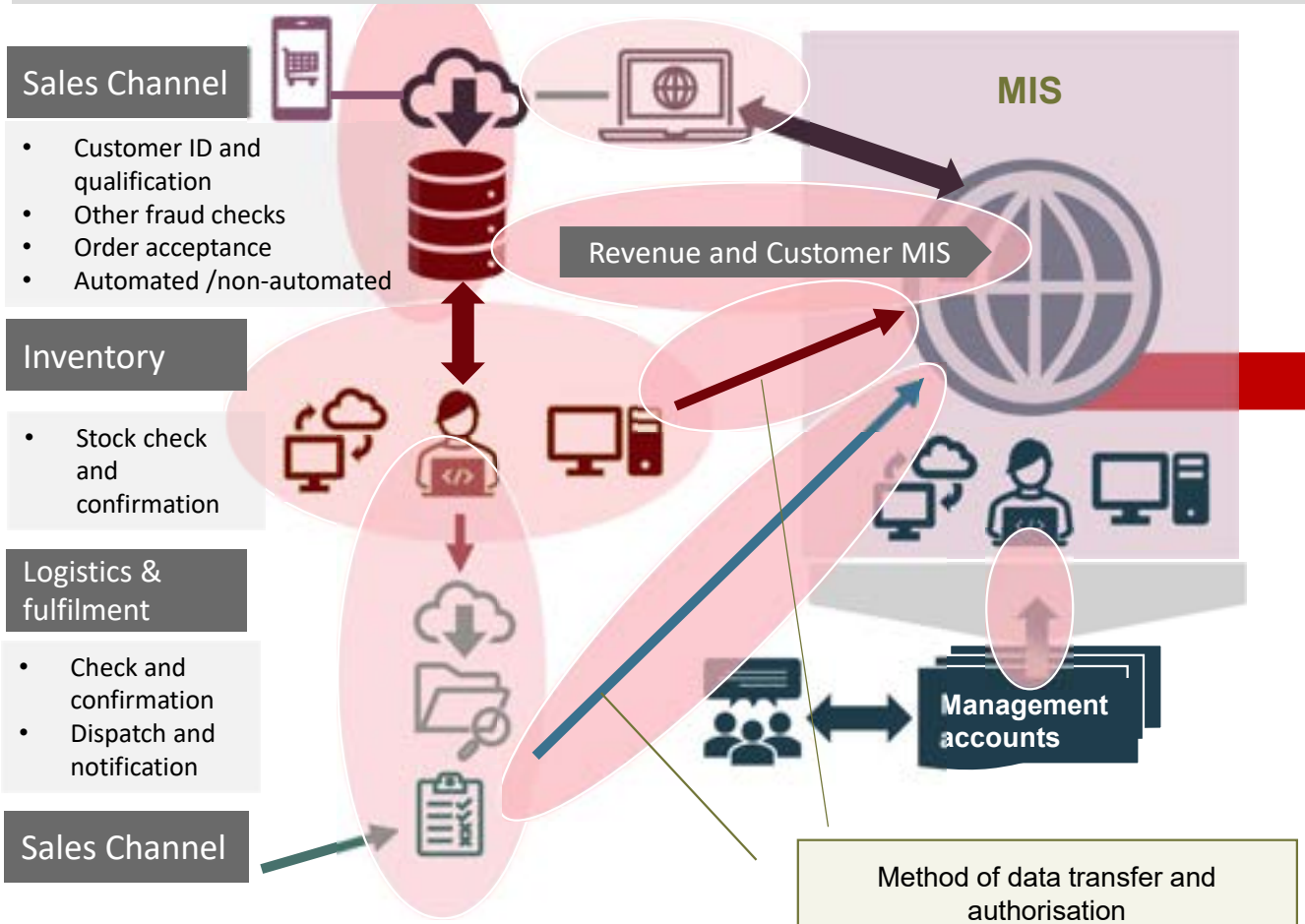
Cash out

- Integrity of payroll platform?
- Who has access?
- Access security?
- How is it kept up to date?
- Change and access log?
- Change authorisation?
- Accreditations and Controls reports

ISA 402?

- Who has access?
- Access security?
- Authorisation security?
- How is data transferred?
- Manual vs automated cross checks
- Two factor verification

Revenue (Internet)



Key GITC Considerations

- Nature of internet hosting/in-house or third party ?
- Who has access?
- Access security?
- Data transfer security?
- Change and access log?
- Change authorisation?

Goods out and Cash in

Inventory, Logistics and fulfilment

- Inhouse or outsourced
- Who has access?
- Access security?
- How is it kept up to date?
- Are checks automated or manual
- Change and access log?
- Exceptions reporting
- Reporting protocols
- Service level agreements

Potential area where:

- **substantive procedures alone aren't enough**
- **Specialist input may be required**

How? Understand – Inquire - Observe - Challenge- Confirm - Evidence

Proportionate

Bottom Up

- Business model led not a discrete activity
- Symbiotic with KAM, significant risks & fraud risk assessment
- Be confident in applying ***common sense*** but, but ***don't be an audit hero*** ~ phone a friend if needs be!
- *Lead discussions* with management and people outside of the finance function
- Clear and effective documentation
- Step back and avoid getting caught in the weeds and distracted by jargon
- Observe and /or use CAATs (where appropriate)
- Be sceptical and challenge – Be creative and get in touch with your dark side!
- **Confirm** **Revisit and reassess during the audit**

Top Down

Evidence – (ISA 500 Suitably Experienced Auditor Test!)

Follow the money! - Transactions – Balances & Disclosures
Going Concern & NoCLaR!
Build independent expectations to support scepticism and make challenge constructive
Avoid familiarity and confirmation bias.
Alert to areas where substantive procedures alone may not be sufficient

Effective two-way communication

Broader perspective and enhanced understanding

How do they manage risk.

Open discussion better than closed checklist

Flowcharts are strongly recommended. *"A picture paints a 1,000 words"*

Checklists are an aide memoire – not evidence

Require a file note demonstrating critical thinking, scepticism and challenge support by evidence:

- Who?
- When?
- What?
- Screen shots?
- SLAs?
- SOC Reports?
- Accreditations
- Etc.

Ensure clear linkage to risk assessment and audit response

Risk Assessment – Supporting the development of an effective response

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The importance of risk assessment

- Senior involvement up front
- Testing can't rescue poor risk assessment

Driving audit quality:

Understanding → Identify & assess risks → Significant risks (including fraud) → Audit strategy → Testing approach

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Hazard perception test 2023: official DVSA guide

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Testing strategy & sample sizes

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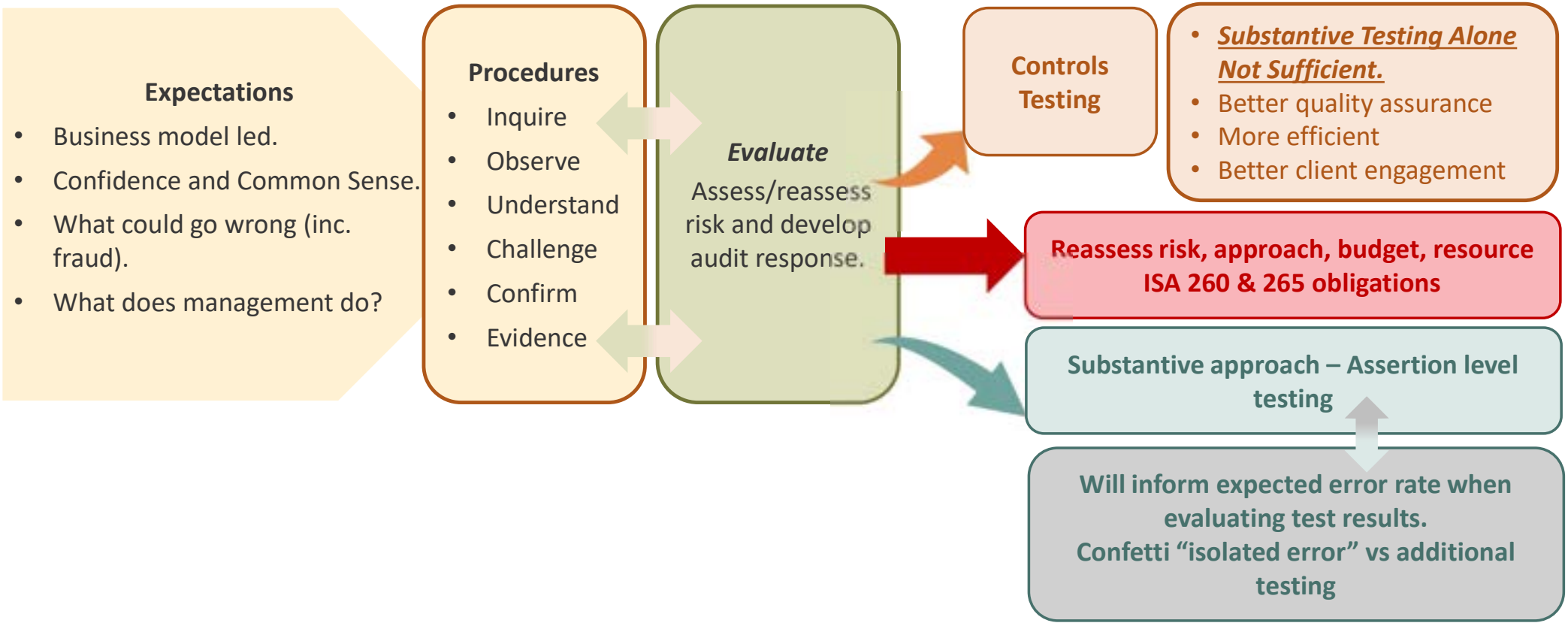
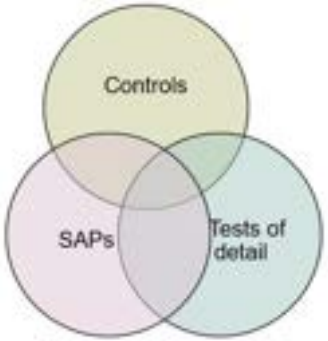
Controls & IT Evaluation - How

Design & Implementation | **Operation & Effectiveness Testing**



Risk assessment & testing strategy



Tests of control

Substantive Analytical Procedures

Substantive tests of detail

- Sampling
- Non-sampling

Data Analytics

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Sample sizes – evidence from other procedures

Testing controls

Substantive Analytical Procedures

Testing key items

Data Analytics (ATTs)

Professional Judgement

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FRC Sampling Thematic Review

Judgements	• Too much evidence from other procedures…or • …not taking enough credit for good evidence!
Key Items	• Insufficient justification – usually size (e.g. “50% PM”) • Good practice – understanding population →Risk Based
Sampling method	• Random vs. Haphazard • Bias (“coverage”) • Justification for method, especially haphazard

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Benefits of testing controls

- Strongly recommended!
  - Reduces substantive sample sizes
  - Better quality audit
  - May rely on year controls testing from previous periods
  - Client service and reporting to TCWG
- Remember: If testing controls over a significant risk area, you must test the controls in the current period
- May be necessary to obtain sufficient audit evidence (e.g. cash sales)
- Remember to test general IT controls as well

Areas where substantive testing alone may not be sufficient

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Risk assessment & controls testing

- Identify key controls
- Focus on frequency of controls
- Low control sample sizes
- Rotational testing

Typical Control sample sizes

Frequency	Sample size
Annual	1
Quarterly	2
Monthly	2-4
Weekly	5-9
Daily	10-15
Transaction	20-30

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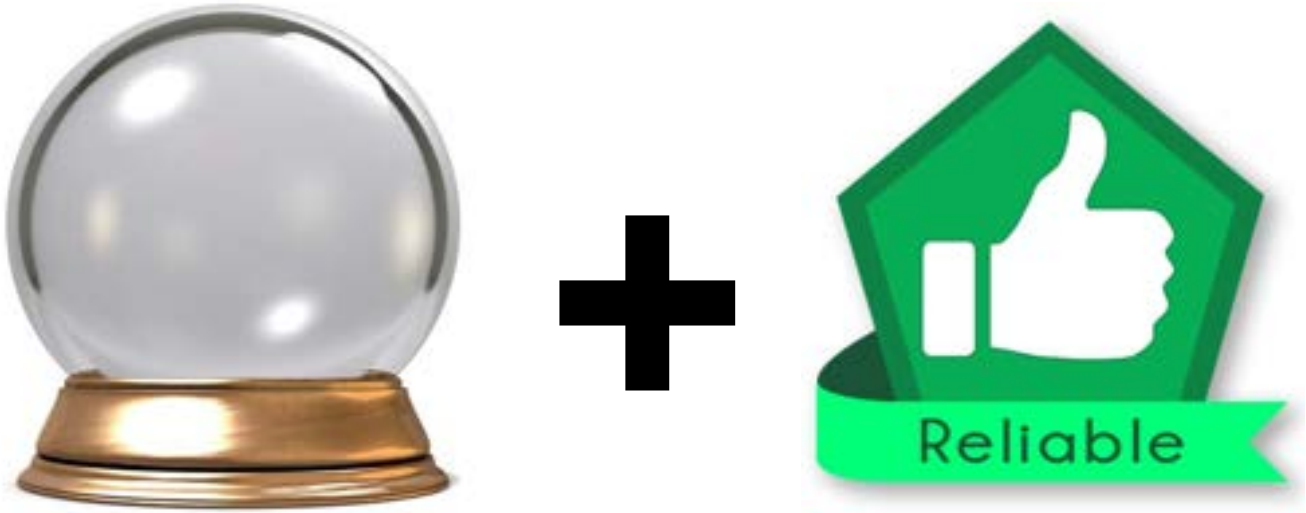
Substantive Analytical Procedures

"evaluations of financial information through analysis of plausible relationships among both financial and non-financial data."



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Where might SAPs work?

Types of SAP	Suitable for…
Predictive model ("proof in total")	• Depreciation • Payroll • Property rental income (residential or commercial) • Hotel room income • Bank interest / Interest expense • Nursing/care home fees • School fees
Expectation based on industry/sector or other similar data	• Retail sales • Restaurant sales • Not-for-profit donation mailshot campaigns • Agricultural yields

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Common pitfalls – planning SAPs

- Not considering whether a sufficiently precise expectation can actually be developed
- Not considering what assertions can be addressed by the substantive analytical procedure
- Not documenting the evaluation of the reliability of the data used, in particular the impact of controls
- Insufficient documentation of judgements

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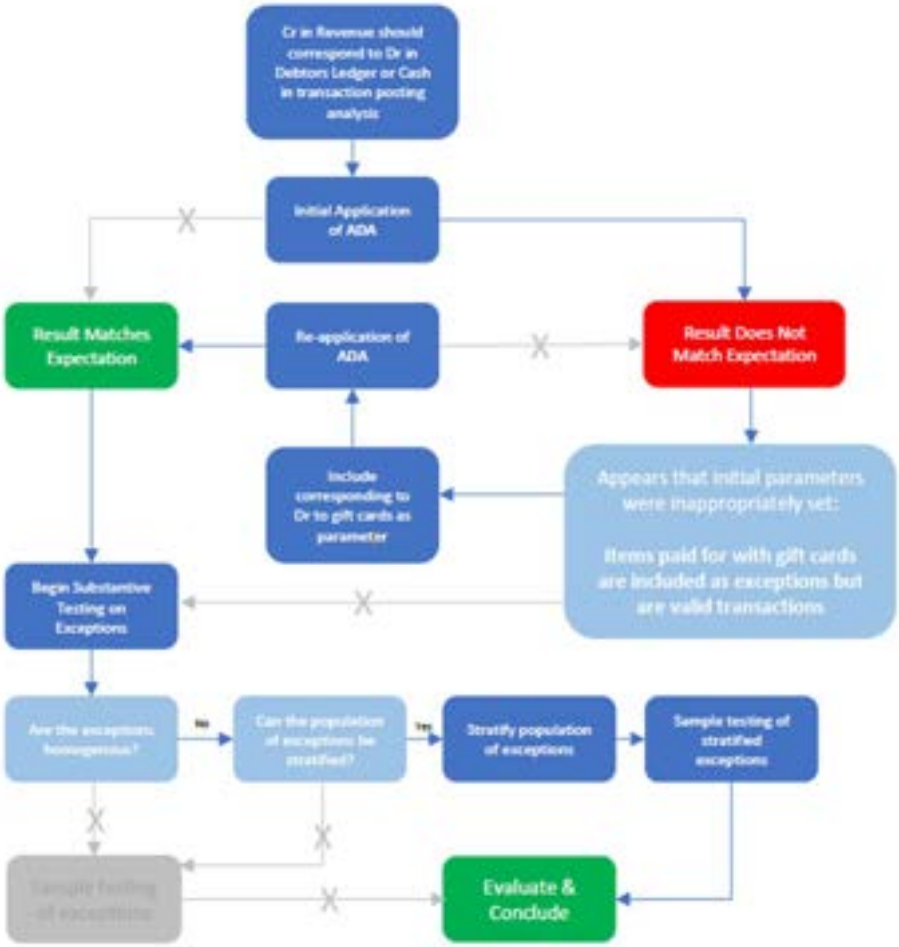
Data Analytics – Responding to Risk

[Addressing Exceptions in the use of Audit Data Analytics 2021 (frc.org.uk)]

- Principles for dealing with outliers* when using **ADA** as substantive testing procedures
- Best practice, pitfalls to avoid and illustrative example (revenue)
- Outliers often due to inappropriate parameters → recalibrate after initial analysis (cf. setting expectations for SAP)



* doesn't match initial expectation (not exceptions at this stage)

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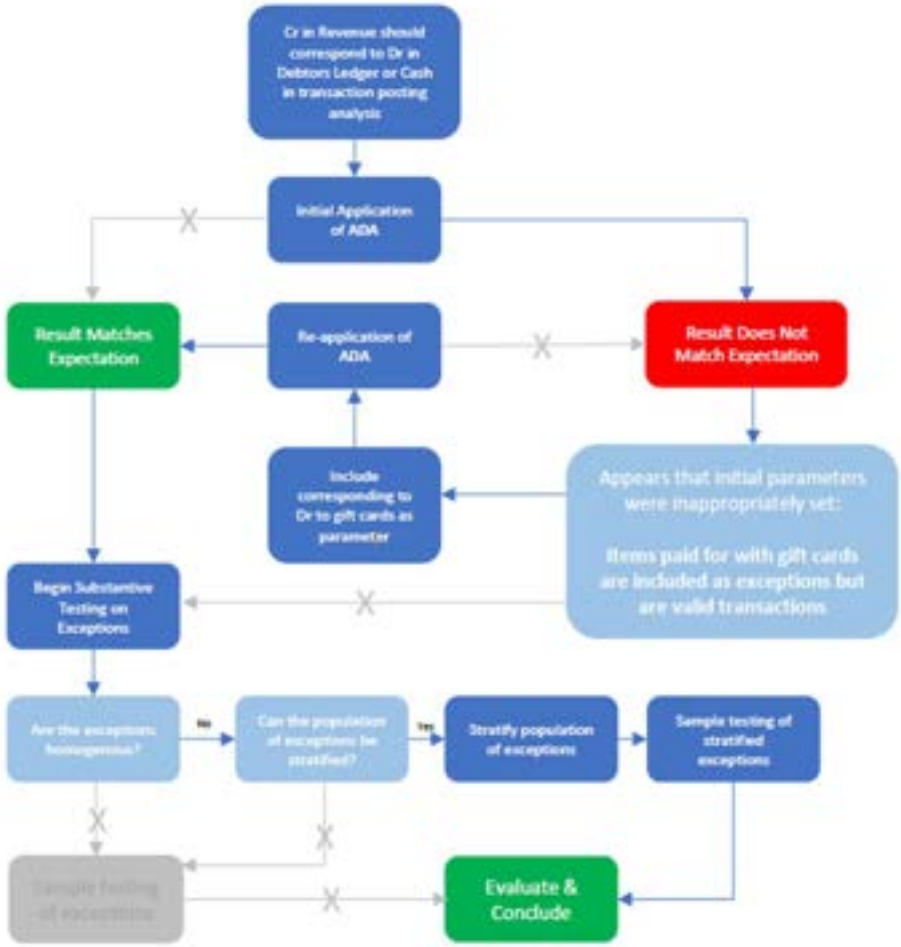
When to use Data Analytics?

- Most effective source of evidence?
- Effective expectations can be set
- Understanding of data flows, systems and controls
- Quality of the data (C, A, V)
- Accessibility and format of data



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Risk Assessment – Documentation and evidence

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Documentation ISA (UK) 315.38

The auditor shall include in the audit documentation:13 (Ref: Para. A237–A241)

- (a) The **discussion among the engagement team** and the **significant decisions** reached;
- (b) **Key elements of the auditor's understanding** in accordance with paragraphs 19, 21, 22, 24 and 25; the **sources of information** from which the auditor's understanding was obtained; and the **risk assessment procedures** performed;
- (c) The **evaluation of the design of identified controls**, and determination **whether such controls have been implemented**, in accordance with the requirements in paragraph 26; and
- (d) The **identified and assessed risks of material misstatement** at the financial statement level and at the assertion level, including **significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence**, and the rationale for the **significant judgments made**.

ISA (UK) 240.48. Rebuttal of presumption of fraud in revenue recognition

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Documentation and evidence

Checklist vs. narrative

Demonstrating scepticism

- Judgements about identifying and assessing risks
- Not biased towards corroborative or excluding contradictory evidence
- Team discussion
- Evaluation of accounting policies (including any changes)
- Evaluation of evidence from risk assessment procedures

Scalability

- Carried forward evidence (updated as necessary)
- More documentation for difficult judgements
- LCE – may be simple and relatively brief
- Document what you did…not what you didn't do! (e.g. not every inherent risk factor considered)

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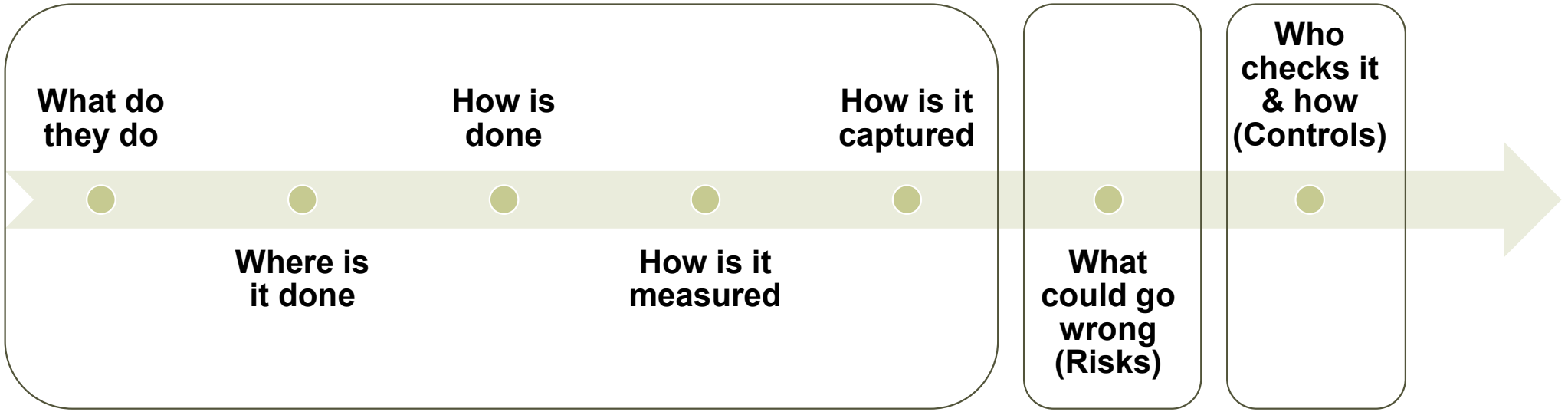
Systems and controls



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Documentation - Judgements

“Firms should ensure that engagement teams understand the importance of appropriate professional judgements and are able to evidence their judgements appropriately.” (FRC Sampling Thematic)

Judgements relevant to risk assessment and audit strategy:

- Decisions reached (team discussion)
- Fraud risks (including rebuttal)
- Significant Risks
- Assessed level of risk
- Testing strategy & sources of evidence
- Sample sizes – impact of other evidence

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Implementation cost: Opportunities

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"We have done all of this, and it has made no difference to our audit, accept add cost – what is the point"

Scenario 1
Great. Your approach has stood up to scrutiny and you now have the evidence required by ISA 315 to justify that approach, making you better able to stand up to scrutiny, if required to do so.

Scenario 2
Shame. As for scenario 1 BUT, have you missed an opportunity to capture assurance in a more efficient and effective way and demonstrate the depth of your business understanding.

Scenario 3
Are you really sure you aren't suffering from a perfect storm of ***confirmation bias and a familiarity threat***.
Is your approach truly objective, ensuring you have not missed any significant risk and your ***audit response will stand up to scrutiny***

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Implementation cost: Opportunities from senior involvement up front

- Maximise impact and return
- Enhance engagement with Audited Entity
- Enhance understanding of the business
- Drive a better (and more efficient) audit response
- Enhance audit quality → Reduced PII, QAD, FRC challenges
- Efficiency & reducing the tail on audits:
    - Effective response to risk (no SALY)
    - reduce or eliminate costs which may be routinely written off
    - reduce archive risks
    - reduce stress on your teams (linked to retention)

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Any questions?

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Thank you for attending

Please take the time to fill out our short survey:

Contact the Audit and Assurance Faculty

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