ISA (UK) 315 – practical issues to consider (Lecture A845 – 17.19 minutes)

ISA (UK) 315 *Identifying and Assessing the Risks of Material Misstatement* is a vast standard that seems to be causing a number of issues with audit firms (as evidenced during file reviews).

Many of the issues found during file reviews appear to be with documenting the systems and controls and the risks associated with those systems and controls. General IT controls seem to be particularly problematic in terms of how they are documented and the risks arising from those controls.

1.1 Going 'back to basics'

ISA (UK) 315 (Revised) does not require the auditor to become an IT auditor. What it is trying to do is to get the auditor to think about the controls that are in place over the client's IT system as a means of assessing the risks of material misstatement in the financial statements.

Illustration 1

Many people nowadays work from home and from the office (known as 'hybrid' working). This will usually involve logging onto the firm's server to carry out their work.

The employee will enter various logon details, including passwords and there may also be a two-way authentication process whereby the user has to input a code that has been sent to another trusted device. Once the user's credentials have been correctly input, the system will allow access.

These are all IT controls to prevent unauthorised access to the IT system.

Illustration 2

A client operates in the haulage business shipping goods from a central warehouse on behalf of its customer. Due to the nature of the business, the warehouse operates 24 hours a day, seven days a week. Warehouse staff are required to work shifts and must enter and exit the warehouse using a swipe card which has their details stored on it electronically. This swipe card records the number of hours worked, including overtime worked.

The electronic time recording system is also linked to the company's payroll system. Each week, the payroll department will import the hours worked from the electronic time recording system into the payroll system. A report is produced detailing the number of hours worked which is reviewed by the warehouse manager. The payroll cannot be finalised until the warehouse manager has signed off that week's hours worked report.

The payroll system automatically calculates the gross pay, statutory deductions and net pay. It also calculates the PAYE/NIC liability due to HM Revenue and Customs each month.

In this cycle, the auditor should review and document:

- The controls in place at the warehouse which aim to prevent employees being paid for hours not worked (entering and exiting the warehouse using the swipe card).

- The controls that are in place to ensure that the hours worked are accurately imported from the

time recording system into the payroll system (the warehouse manager authorising the hours worked or a reconciliation carried out by the payroll department).

- Access controls over the payroll system itself.

- Controls over the payroll processing – ie, whether any reviews of information output from the payroll system is reviewed by a senior official prior to the payroll being finalised.

- Controls over the payment of the payroll to employees, ie, looking for segregation of duties between the payroll department and the physical payment of the payroll to employees.

Flowcharts may be a useful way of identifying any missing controls in this process.

Here, the auditor is trying to identify the controls over the IT systems (and the payroll cycle itself) to ensure that there is a control in place at each stage of the process.

1.2   Use of spreadsheets by a client

Despite many modern accounting systems being powerful, clients tend to maintain spreadsheets for several aspects of the accounting system. These can be straightforward documents, or highly sophisticated ones containing many thousands of formulae to produce information that management needs for the decision-making process.

A commonly quoted statistic is that as many as 90% of spreadsheets contain mistakes. While many of these errors are generally minor, from an auditing perspective, a lot of small errors can add up and end up being material. It is important that the auditor carries out procedures that provides them with confidence that the data they have been given is reliable.

Risk is also another factor that auditors need to keep in mind where spreadsheets are concerned. If an IT system produces reports in the form of a spreadsheet (which most systems do nowadays), there is a risk that the data can be manipulated by the user. Manipulation can involve changing amounts/formulae/deleting information either intentionally or unintentionally. Either way, this invariably becomes a risk of material misstatement at the financial statement level.

Example – Sophisticated Enterprise Resource Planning (ERP) system

Sunnie Enterprises Ltd has a bespoke ERP system in place which includes the accounting system. The financial controller prepares monthly management accounts and prepares the year-end trial balance. The finance director prepares the draft accounts ready for the auditors from the year-end trial balance.

The ERP system has been fully documented by the audit engagement team and tests of controls have been carried out during an interim audit which revealed the IT controls are working effectively.

A lot of the data from the ERP system is exported into manual spreadsheets which are used in the financial reporting process. As the financial controller prepares this documentation from a sophisticated accounting system, there are no further checks on this data.

In this situation, despite the business having a sophisticated accounting system with effective controls, these controls essentially become redundant once the data is worked on in a manual spreadsheet. Once work on the spreadsheets starts, no further checks are carried out.

The difficulty in this situation is that there is little in the way of an audit trail where the spreadsheets are concerned. Hence it is difficult for the auditor to track changes and understand who made those changes.

ISA (UK) 500 *Audit Evidence* requires the auditor to evaluate when information provided by the audited entity is sufficiently reliable for the purposes of the audit. This includes obtaining audit evidence concerning the accuracy and completeness of the information and evaluating whether the information is sufficiently precise and detailed.

At the planning stage of the audit, the audit engagement team would need to devise appropriate audit procedures over these spreadsheets, including ensuring the correct version is being audited.

The other issue that is often encountered when carrying out audit work is that some clients will often present information that has been exported from an accounting system into a spreadsheet and the information presented to the auditor is presented in a PDF format. Basic checks, such as checking for arithmetical accuracy, can be carried out on the PDF, but the important issue the auditor must consider is whether the underlying data is correct. For example, are the formulae correct and has the 'raw' data from the accounting system been exported correctly into the spreadsheet (the auditor could perform a reconciliation of the information in the accounting system to the information presented in the spreadsheet). In any event, it is important that the auditor asks for the original spreadsheet so they can carry out audit procedures to verify the underlying information and ensure accuracy.

Analytical review procedures

The auditor can use analytical procedures over a spreadsheet as a means of identifying potential sources of misstatement. For example, recalculating amounts in the spreadsheet, or using ratios can provide the auditor with indicators that the amounts in the spreadsheet need to be challenged, or they can confirm that the results are reasonable.

Trend analysis is also a key tool at the auditor's disposal, especially where spreadsheets are concerned. These sorts of charts can assist an auditor identify patterns or trends that either contradict the auditor's expectations or confirm them.

Substantive procedures

Substantive procedures on a spreadsheet are often the most effective in identifying misstatements. Remember, substantive procedures aim to detect misstatements so carrying out such testing on spreadsheets is very useful. Such tests may include:

- Reviewing formulae to identify if there are any errors or omissions (particularly with larger spreadsheets).

- Inspecting the spreadsheet as Excel has a function to inspect a workbook and identify potential issues.

- Identifying any inconsistencies in the spreadsheet which may be manipulating the final result or output of the information in the spreadsheet (eg, balancing figures).

- Reperforming calculations to assess if the auditor's output is consistent with the client's output.

1.3 Summary

The technical provisions of ISA (UK) 315 (Revised) have been covered a lot in previous updates. A lot of what is in the standard is common sense and requires a logical thought process to be put in place. For example, how do transactions and balances start their journey from initial entry into the accounting system to the financial statements? What processes and controls are there during this journey to ensure they end up in the right place? The key is then documenting this journey and the controls in place to ensure the transactions and balances end up at the right destination in the financial statements.