KAEG-I [INTL VERSION 2024]: ISA 330 The Auditor's Responses to Assessed Risks

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ISA 330 The Auditor's Responses to Assessed Risks

View the Full Chapter for this Standard

ISA 330 *The Auditor's Responses to Assessed Risks*

(Effective for audits of financial statements for periods beginning on or after December 15, 2009)

International Standard on Auditing (ISA) 330, *The Auditor's Responses to Assessed Risks*, should be read in conjunction with ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.*

Introduction, Objective and Definitions

International Standards on Auditing: ISA 330.01-04

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with ISA 315 (Revised 2019)[1] in an audit of financial statements.

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1 ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

Effective Date

2. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

Objective

3. The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks.

Definitions

4. For purposes of the ISAs, the following terms have the meanings attributed below:

(a) Substantive procedure - An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:

(i) Tests of details (of classes of transactions, account balances, and disclosures); and

(ii) Substantive analytical procedures.

(b) Test of controls - An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Overall Responses

International Standards on Auditing: ISA 330.05 Requirements

Overall Responses

5. The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. (Ref: Para. A1-A3)

ISA Application and Other Explanatory Material: ISA 330.A1-A3

Application and Other Explanatory Material

Overall Responses (Ref: Para. 5)

A1. Overall responses to address the assessed risks of material misstatement at the financial statement level may include:

- Emphasizing to the engagement team the need to maintain professional skepticism.
- Assigning more experienced staff or those with special skills or using experts.
- Changes to the nature, timing and extent of direction and supervision of members of the engagement team and the review of the work performed.
- Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
- Changes to the overall audit strategy as required by ISA 300, or planned audit procedures, and may include changes to:
    - The auditor's determination of performance materiality in accordance with ISA 320.
    - The auditor's plans to tests the operating effectiveness of controls, and the persuasiveness of audit evidence needed to support the planned reliance on the operating effectiveness of the controls, particularly when deficiencies in the control environment or the entity's monitoring activities are identified.
    - The nature, timing and extent of substantive procedures. For example, it may be appropriate to perform substantive procedures at or near the date of the financial statements when the risk of material misstatement is assessed as higher.

A2. The assessment of the risks of material misstatement at the financial statement level, and thereby the auditor's overall responses, is affected by the auditor's understanding of the control environment. An effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity and thus, for example, allow the auditor to conduct some audit procedures at an interim date rather than at the period end. Deficiencies in the control environment, however, have the opposite effect; for example, the auditor may respond to an ineffective control environment by:

- Conducting more audit procedures as of the period end rather than at an interim date.
- Obtaining more extensive audit evidence from substantive procedures.
- Increasing the number of locations to be included in the audit scope.

A3. Such considerations, therefore, have a significant bearing on the auditor's general approach, for example, an emphasis on substantive procedures (substantive approach), or an approach that uses tests of controls as well as substantive procedures (combined approach).

How do we comply with the Standards?

[ISA | KAEGHDWC]

1 Design and implement audit responses [ISA | 781]

What do we do?

Design and implement audit responses that address the risks of material misstatement

Why do we do this?

Our audit responses to identified and assessed risks of material misstatements (RMMs) provide us with sufficient appropriate audit evidence to reduce audit risk to an appropriately low level. We have two types of audit response to these RMMs - overall responses and responses that involve the nature, timing and extent of audit procedures. If our audit responses are not appropriate, we will fail to reduce audit risk to an appropriate level.

Execute the Audit

What are the types of audit responses to identified RMMs? [ISA | 781.1400]

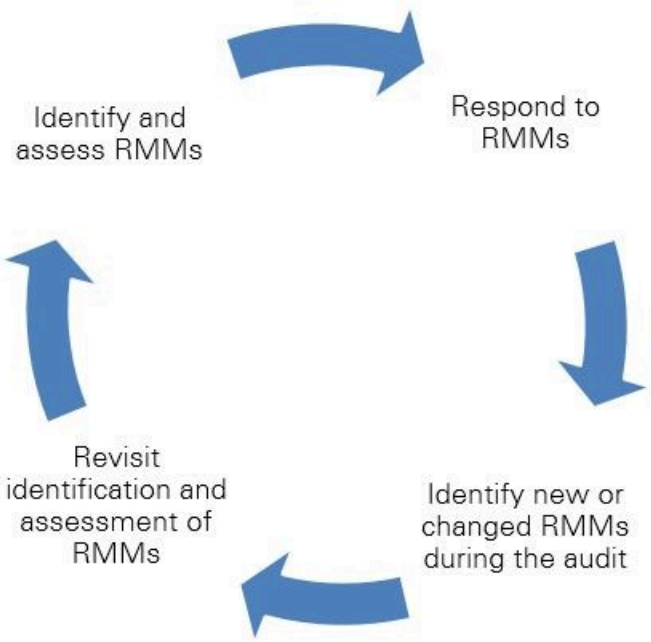
We employ two broad types of audit responses to RMMs.

Overall responses	Responses that have an overall effect on how the audit is conducted
Assertion-level responses	Responses involving the nature, timing and extent of audit procedures

The nature of these two types of audit responses differs, but together they help us to design audit responses that sufficiently address the RMMs we have identified and assessed.

What if we identify new RMMs or revise our assessment of RMMs? [ISA | 781.1500]

The audit is a continual process, during which we may, and often will, identify new RMMs or revise our assessment of RMMs. In this case, we revisit our risk assessment and revise our planned approach to address these changes.



1.1 Design and implement overall responses [ISA | 782]

What do we do?

Design and implement overall responses to address the risks of material misstatement

Why do we do this?

Overall responses lay the foundation for the rest of our audit procedures. They also act together with our assertion-level responses to help us obtain sufficient appropriate audit evidence. Overall responses affect how the overall audit is conducted and performed. Whereas, assertion-level responses relate to the nature, timing and extent of the procedures we perform over each assertion-level RMM.

If we fail to design and implement an appropriate overall response to the audit, our assertion-level responses are unlikely to meet our audit objective.

Execute the Audit

What are overall responses? [ISA | 782.1300]

We may design and implement two different types of overall responses.

Type of response	Responses
General overall responses	• Assigning significant engagement responsibilities appropriately • Providing appropriate supervision • Selecting audit procedures with elements of unpredictability

	• Evaluating the entity's selection and application of significant accounting policies or principles
Other overall responses - e.g. how we respond to identified pervasive financial statement-level risks	• Making pervasive or general changes to the nature, timing and extent of our audit procedures

When do we design and implement overall responses? [ISA | 782.11520]

We always perform the following overall responses to respond to the assessed risks of material misstatement on every audit, regardless of whether we have identified an entity specific financial statement level risk or not:

- Making appropriate assignments of significant engagement responsibilities. The knowledge, skill, and ability of engagement team members with significant engagement responsibilities is to be commensurate with the assessed risks of material misstatement.
- Providing the extent of supervision that is appropriate for the circumstances, including, in particular, the assessed risks of material misstatement.
- Incorporating elements of unpredictability in the selection of audit procedures to be performed. As part of our response to the assessed risks of material misstatement, including the assessed fraud risks, we incorporate an element of unpredictability in the selection of auditing procedures to be performed from year to year.
- Evaluating the entity's selection and application of significant accounting policies or principles. We evaluate whether the entity's selection and application of significant accounting policies or principles, particularly those related to subjective measurements and complex transactions, are indicative of bias that could lead to material misstatement of the financial statements.

Overall responses can also help us address risks of material misstatement at the financial statement level and **assertion-level**.

Can a specific overall response address multiple financial statement level risks?

Yes.

What effect might the control environment have on our overall responses? [ISA | 782.11521]

An effective control environment may allow us to have more confidence in both internal controls and the reliability of audit evidence generated within the entity.

This can affect our assessment of RMMs and how we respond to them. For example, we may be able to perform some audit procedures at an interim date rather than at the period end.

Deficiencies in the control environment, however, have the opposite effect. For example, we may respond to an ineffective control environment by:

- conducting more audit procedures as of the period end rather than at an interim date;
- obtaining more extensive audit evidence from substantive procedures; and/or
- including more locations in the scope of our audit.

Such considerations, therefore, have a significant bearing on our general approach - for example, whether we take:

- a substantive approach - i.e. placing an emphasis on substantive procedures; or
- a combined approach - i.e. using tests of controls as well as substantive procedures.

How are overall responses different from assertion-level responses? [ISA | 782.1500]

Overall responses affect how we conduct the audit broadly. Assertion-level responses are more specific than overall responses, as they focus on tests of controls and substantive procedures designed to address assertion-level RMMs.

Why do we apply both overall and assertion-level responses? [ISA | 782.1600]

To illustrate why we apply both overall and assertion-level responses to appropriately respond to risks, consider this non-financial example.

> In our daily lives, we often perform activities whose success depends on a combination of both overall and specific approaches. Consider gardening, for example. We take some actions that are intended to affect only certain plants, such as pruning, relocating a plant to get more or less sun, or watering selectively.
>
> However, we also act in ways that are intended to affect the entire garden. We might change the soil, apply fertilizer or adjust the overall watering schedule. Ultimately, the combination of both types of activity is what helps us maintain a healthy garden.

1.1.1 Assign significant engagement responsibilities [ISA | 783]

What do we do?

Determine overall responses to address risks of material misstatement by appropriately assigning significant engagement responsibilities

Why do we do this?

We do a number of things to design and implement an overall response to risks of material misstatement (RMMs). Among these activities, we appropriately assign significant engagement responsibilities. If we don't, we do not meet our professional responsibilities and risk not obtaining sufficient appropriate audit evidence to address the RMMs.

Execute the Audit

What significant engagement responsibilities do we assign? [ISA | 783.1400]

Significant engagement responsibilities that we assign include:

- supervision
- review of the audit documentation

- procedures to be performed over RMMs that have higher inherent risk, including fraud risks.

Which RMMs are likely to have a higher inherent risk? [ISA | 783.11575]

RMMs associated with matters that are complex and involve judgment and estimation are likely to have a higher inherent risk - e.g. RMMs related to valuation of loan loss reserves, business combinations, actuarial estimates for benefit plans, estimates for warranty reserves.

Fraud risks are also considered significant risks and have a higher inherent risk as well - e.g. revenue recognition at period end, risk of management override through the recording of inappropriate journal entries and other adjustments.

What do we consider when we assign significant engagement responsibilities? [ISA | 783.1500]

In assigning significant engagement responsibilities, we consider:

- the level of subject matter expertise that is appropriate, including specialists and specific team members; and
- the knowledge, skill and ability of each engagement team member.

We also watch for changes during the audit that may cause us to revise the assignment of significant engagement responsibilities - e.g. we identify a new RMM with Significant or Elevated inherent risk, we identify a new complex transaction entered into by the entity.

When assigning and considering significant engagement responsibilities throughout the audit, we consider the assessed level of risk and the knowledge, skills, and abilities necessary. Responsibilities that involve complex and specialized subject matter for which we lack the necessary knowledge or experiences may also lead us to involve specialists and specific team members.

For example, we may involve specialists and specific team members when we perform:

- procedures over environmental remediation liability estimation
- life insurance benefit reserves
- the valuation of acquired assets in a business combination
- journal entry testing.

How can we assign significant engagement responsibilities to address a financial statement level risk? [ISA | 783.11576]

We might assign significant engagement responsibilities in response to a financial statement level risk in a number of ways, including:

- changing the overall composition of the engagement team to include team members that have more experience (e.g., assigning an engagement partner with 25 years of experience instead of a partner with 15 years of experience) or specific skills (e.g., significant experience in a particular industry or particular type of transaction);
- including specialists or specific team members - e.g., forensics professionals; and
- considering those accounts, disclosures and assertions that could be impacted by the risk and using more experienced auditors to perform the procedures in those areas - e.g., **journal entry testing.**

Examples

How do we assign significant engagement responsibilities? [ISA | 783.1600]

Example 1

Suppose an entity entered into a business combination during the period we are auditing. A new associate with limited experience may not be the best team member to perform audit procedures related to the business combination. They would lack the relevant experience and background to assess the entity's judgments and estimates. We would likely assign a more experienced team member and consider whether the assumptions and methodologies used to account for the business combination call for the involvement of a specialist.

Example 2

Suppose we identify changes in the IT environment that could pervasively affect the audit. We would likely not assign engagement team members without an IT background to assess these changes. These team members may lack the knowledge, experience and skills to identify and assess how all the changes affect the entity's financial reporting process. We may consider involving IT Audit specific team members with the relevant IT expertise.

Example 3

Suppose we are assigning engagement responsibilities for the fraud risk associated with management override of controls - i.e. booking inappropriate journal entries. We may assign a lower level engagement team member to test journal entries. However, the increased risk leads us to involve more experienced engagement team members or individuals with specialized skills and knowledge such as those with forensic or relevant IT expertise in planning, supervising and reviewing the procedures perform and evaluating the results.

1.1.2 Supervise engagement team members [ISA | 784]

What do we do?

Determine overall responses to address risks of material misstatement by appropriately supervising engagement team members

Why do we do this?

We do a number of things to design and implement our overall response to risks of material misstatement (RMMs). Among these activities, we appropriately supervise engagement team members. This is part of our professional responsibilities, and it applies to the entire team, including specialists and specific team members. If we don't supervise them appropriately, we may not obtain sufficient and/or appropriate audit evidence to address the RMMs.

Execute the Audit

What is appropriate supervision? [ISA | 784.1400]

As part of appropriately supervising personnel, we:

- inform them of their responsibilities;
- direct them to alert supervising engagement team members of significant issues that arise during the audit;

- review their work to evaluate whether:
  - the work was documented appropriately;
  - the objectives were achieved; and
  - the results of the work support the conclusions.

Appropriate supervision also includes:

- tracking the audit engagement's progress;
- considering the competence and capabilities of individual engagement team members, including whether they:
  - have enough time to do their work;
  - understand their instructions; and
  - are doing their work in line with the planned approach to the audit engagement;
- addressing significant matters arising during the audit engagement, considering their significance, and modifying the planned audit approach as needed; and
- identifying matters for more experienced engagement team members to consider during the audit engagement.

How do we supervise a specialist and/or specific team member? [ISA | 784.1500]

When our engagement includes specialists and specific team members, we direct, supervise and review their work by:

- agreeing with the specialists and specific team members on the nature, scope and objectives of their work;
- agreeing on the roles of the specialists and specific team members and other engagement team members, and on the nature, timing and extent of communication between them; and
- evaluating the adequacy of the specialists and specific team member's work, including whether their findings and conclusions are relevant, reasonable and consistent with other audit evidence.

What affects the extent of our supervision? [ISA | 784.1600]

We base the extent of our supervision on the audit's facts and circumstances, including:

- the nature of the entity, including its size and complexity;
- the nature of the work assigned to each engagement team member, including the procedures to be performed and the controls or accounts and disclosures to be tested;
- the associated RMM; and
- the knowledge, skills and abilities of each engagement team member.

Our level of supervision also is affected by our assessment of an RMM. We increase the extent of supervision for RMMs that have a higher assessed inherent risk.

How do we increase the extent of our supervision? [ISA | 784.1700]

We increase the extent of our supervision by:

- dedicating more time and effort to our supervision and review; and
- assigning a more experienced engagement team member to supervise and review.

What are some ways we can dedicate more time and effort to our supervision and review? [ISA | 784.1800]

We are able to dedicate more time and effort to our supervision and review by:

- setting up time with engagement team members upfront to discuss their responsibilities and expectations;
- planning for status 'check-ins' with engagement team members to provide them opportunities to ask questions;
- performing a more in-depth review of the audit documentation produced;
- conducting more meetings with the other members of the engagement team to discuss the procedures performed, the evidence obtained, and the conclusions reached;
- performing reviews earlier in the process and continue through the conclusions being reached; and
- planning and performing debrief sessions with the engagement team members in-between individual assignments to provide timely feedback.

Who is responsible for appropriate supervision? [ISA | 784.1900]

The engagement partner is ultimately responsible for properly supervising the work of engagement team members. However, all team members with supervision responsibilities are responsible for exercising appropriate supervision in fulfilling their responsibilities.

When do we provide supervision? [ISA | 784.2000]

We provide supervision throughout the audit - from engagement acceptance and planning through reviewing engagement team members' work to forming our conclusion and issuing our report.

How can we supervise engagement members to address a financial statement level risk? [ISA | 784.11577]

We might supervise engagement members in response to a financial statement level risk in a number of ways, including:

- inclusion of certain additional team members in our RAPD meeting, which strategically allows for engagement team members to have a good understanding of more experienced team members' views about risks and how fraud might be perpetrated. This sets helps to set the tone from the top by setting the model of a proper degree of skepticism and set the culture for the engagement;
- increasing the number of reviews - e.g., having both partner and manager review of all audit workpapers;
- broadly altering the timing of reviews of audit documentation to occur at earlier points in the audit - e.g., setting milestone dates for when reviews of certain audit areas are to be completed throughout the audit, completing all reviews at least one week before issuing the audit opinion; and
- performing 'pre-issuance' reviews by professionals that are not a part of the engagement team - e.g., national office monitoring programs, DPP reviews.

Examples

What may happen if we don't provide appropriate supervision? [ISA | 784.2100]

Fact pattern:

The engagement team identified a fraud risk related to recognition of revenue at period end.

Appropriate supervision was provided over:

- risk assessment, including understanding the process, identifying the applicable process risk points, and evaluating the design and implementation of process control activities;
- the planned nature, timing and extent of control testing to address the applicable process risk points, including manual and automated process control activities and any system-generated reports used to support the process control activities;
- the planned test of operating effectiveness of process control activities and evaluation of results; and
- the planned substantive procedures - i.e. nature, timing and extent - including incorporating elements of unpredictability.

After the team performed their risk assessment procedures and planned their audit approach, a first-year associate joined the engagement team. The associate was assigned to perform both the tests of controls and substantive procedures to address the fraud risk. The associate was not appropriately supervised when performing these procedures.

Analysis:

The engagement manager reviewed the process control activities and substantive procedures in detail and determined that the associate did not perform the procedures in line with the planned audit approach.

The engagement manager did not adequately communicate and explain the detailed procedures to the associate responsible for performing them. The engagement manager also did not periodically check in with the associate as the procedures were performed.

The engagement manager therefore did not provide adequate or appropriate supervision in a timely manner.

As a result, additional work was performed by the engagement team to obtain sufficient appropriate audit evidence related to the fraud risk.

1.1.3 Incorporate elements of unpredictability [ISA | 785]

What do we do?

Determine overall responses to address risks of material misstatement by incorporating elements of unpredictability in the selection of audit procedures

Why do we do this?

If we perform the same procedures year after year, management could fraudulently manipulate financial information in areas they don't expect us to audit. Certain procedures naturally include some elements of unpredictability (e.g. use of audit sampling, in particular MUS, where items are selected haphazardly or at random).

By also deliberately incorporating other unpredictable procedures, we may:

- gain added assurance that the entity's transactions are appropriately accounted for in accounts we have not historically audited;
- identify new RMs or reassess as RMMs;

- identify processes and procedures that are not functioning as intended; and
- uncover attempts to conceal fraudulent actions, particularly by people who are familiar with our techniques and procedures.

Execute the Audit

Which RMMs can elements of unpredictability address? [ISA | 785.1400]

The incorporation of an element of unpredictability in every audit can help address any risk of material misstatement, including both assertion-level RMMs and financial statement level risks.

Additionally, we specifically incorporate elements of unpredictability when we address fraud risks.

How can we incorporate elements of unpredictability into the design of our audit procedures? [ISA | 785.1500]

We can incorporate elements of unpredictability by modifying the nature, timing and extent of our audit procedures.

How can we incorporate elements of unpredictability into our substantive audit procedures? [ISA | 785.11578]

The following table sets out examples of ways we might modify our substantive audit procedures to incorporate elements of unpredictability. When we design our substantive audit procedures for different areas of the audit, we may use any of these or other techniques, or a combination of them.

Changes to the nature, timing or extent of substantive audit procedures	Example
Perform audit procedures related to accounts, disclosures and assertions that would not otherwise be tested based on their amount or the auditor's assessment of risk	Perform procedures on prepaid expenses or other accounts that do not have a related RMM (i.e., a nonsignificant account)
Vary the timing of audit procedures	Send accounts receivable confirmations as of the end of the period as opposed to an interim date
Select items for testing that have lower amounts or are otherwise outside customary selection parameters	Reduce the dollar value used to select items to examine when searching for unrecorded liabilities Confirm low-balance or bank accounts not tied to a relevant business process. Select additional journal entries for testing that do not meet the high-risk criteria

Perform unannounced audit procedures	Perform an inventory observation without announcing the date to management and/or inventory warehouse staff
Increase the extent of our substantive procedures	Select a greater sample size than the minimum
Perform different types of substantive testing procedures	Perform a substantive analytical procedure (SAP) in addition to sampling, where appropriate, or also perform a substantive test of details where we have traditionally performed a SAP only
Varying our selection technique	Performing audit sampling where we may have ordinarily used specific item sampling to select high value items
In group audits, vary the location or the nature, timing and extent of audit procedures at related components from year to year	Perform audit procedures for a smaller component where we have not done so historically

How can we incorporate elements of unpredictability into our tests of controls? [ISA | 785.11579]

The following table sets out examples of ways we might modify our tests of controls to incorporate elements of unpredictability. When we design our tests of controls for different areas of the audit, we may use any of these or other techniques, or a combination of them.

Changes to the nature, timing, and extent of tests of controls	Example
Vary the nature of tests of controls	Re-performing the control in addition to observing the control being performed or inspecting evidence produced as part of the operation of the control
Vary the timing of tests of controls	Test controls closer to the date of management's assessment as opposed to an interim date, and vary the dates of the control instances selected.

Vary the extent of tests of controls	Selecting a greater sample size than the minimum sample size
In group audits, vary the location or the nature, timing and extent of audit procedures at related components from year to year	Perform test of controls at a smaller component where we have not done so historically

How do we evidence elements of unpredictability? [ISA | 785.1600]

We document the specific element of unpredictability that we have incorporated into the audit as part of our overall response. When the method of incorporation of the element of unpredictability in the audit is by performing audit procedures over accounts that would not otherwise be tested, we document not only the procedure's results but also why we performed them - i.e. to incorporate unpredictability. This is so an experienced auditor with no previous connection with the engagement does not misunderstand the reason for our procedures or think that we failed to appropriately address an RMM in the audit.

> For example, if incorporate an element of unpredictability by identifying and testing controls related to a non significant account, failing to document our reason for the testing could cause a reviewer to believe that there is a RMM related to the account that we failed to design and perform appropriate substantive procedures to address.

When can adding an element of unpredictability be ineffective? [ISA | 785.1700]

Adding an element of unpredictability can be ineffective if we arbitrarily introduce unpredictability into our procedures that do not provide meaningful audit evidence.

When we design our audit response to incorporate an element of unpredictability, we consider the nature of our identified risks and how unpredictability may increase the persuasiveness of audit evidence.

> For example, an engagement team incorporates an element of unpredictability by selecting lower dollar value items and testing whether payments made are accurately recorded as prepaid expenses. This procedure may not provide much additional audit evidence, especially if the balance of the prepaid expense account is small and/or the number of incremental items selected for testing is not meaningful.
>
> By contrast, suppose the balance of the prepaid expense account is larger or could be used by management to record a variety of different types of transactions (i.e., used as a suspense account). In these cases, performing audit procedures over prepaid expenses when the team has not done so historically adds an element of unpredictability and provides meaningful audit evidence.

Examples

How can we incorporate an element of unpredictability? [ISA | 785.1800]

Fact pattern 1

As part of risk assessment procedures, an engagement team identifies an RMM related to inappropriate revenue recognition at or near period end - i.e. revenue cut-off. In designing their audit responses, the team considers ways to incorporate an element of unpredictability into their audit procedures.

Analysis

The team could choose to incorporate unpredictability through many different procedures. They decide they would gain meaningful audit evidence by:

- confirming the relevant contract terms of accounts receivable, including acceptance criteria, delivery and payment terms, any future vendor obligations, rights of return, cancellation or refund provisions, and the absence of any side agreements;
- performing period-end inventory observations and specific sales cut-off testing for two locations where no audit procedures were performed for the past 3 years because of their size and lack of specific risks - and performing the inventory observations unannounced; and
- selecting contracts with multiple performance obligations that are fulfilled close to year end and inspecting documentation for evidence that all performance obligations have been satisfied at year end.

Fact pattern 2

As the engagement team performed its risk assessment procedures, they identified an RMM related to the valuation of alternative investments, which do not have readily available market prices. In designing their audit responses, the team considered ways they might incorporate an element of unpredictability into their audit procedures.

Analysis

The team could choose to incorporate unpredictability through many different procedures. They decided they would gain meaningful audit evidence by having an employed KPMG specialist independently price a selection of the alternative investments and comparing those values to the values reported by the entity, which was not done in the past.

1.1.4 Evaluate significant accounting principles and policies [ISA | 786]

What do we do?

Determine overall responses to address risks of material misstatement by evaluating the entity's selection and application of significant accounting principles and policies for bias

Why do we do this?

We do a number of things to design and implement an overall response to risks of material misstatement (RMMs). Among these activities, we evaluate the entity's selection and application of significant accounting principles and policies.

Financial reporting frameworks - e.g. US GAAP, IFRS - are not strictly rules-based. They allow management to select and interpret accounting principles and policies in many cases. As a result, management's selection or application of accounting principles and policies may technically comply with the framework, but the selection may be biased toward a particular outcome - e.g. fraudulently increasing short-term net income, masking certain trends or events.

Execute the Audit

How do we identify the entity's significant accounting principles and policies? [ISA | 786.1400]

We identify the entity's significant accounting principles and policies by considering which principles and policies:

- have alternatives;
- require judgment on the part of management to apply;
- relate to subjective measurements;
- relate to complex transaction; or
- may indicate management bias - e.g. where there is a pattern of management taking a conservative or aggressive approach or where management may be managing earnings.

How do we evaluate the entity's selection and application of significant accounting principles and policies? [ISA | 786.1500]

When we evaluate how the entity has selected and applied significant accounting principles and policies, we seek to understand:

- the methods used to account for significant and unusual transactions;
- the effect of significant accounting principles and policies in controversial or emerging areas where authoritative guidance or consensus is lacking;
- changes in the entity's accounting principles and policies; and
- financial reporting standards and laws and regulations that are new to the entity, including when and how the entity will adopt them.

We also evaluate whether the company's selection and application of significant accounting principles and policies may indicate management bias, with focus on:

- accounting principles and policies that relate to subjective measurements and complex transactions; and
- principles and policies that have more than one acceptable accounting method or allow management to select from several alternatives.

In these areas, the possibility increases that management may lack neutrality in selecting and applying accounting principles and policies - intentionally or not.

What is management bias? [ISA | 786.1600]

Management bias arises when management lacks neutrality in preparing the financial statements.

Management may prefer a certain accounting outcome because of its impact on the entity's financial statements - e.g. increased profit. This may affect management's judgments and decisions when selecting and applying significant accounting principles and policies, leading to financial statements

that are biased. This can occur even if management's bias is subconscious and does not intend to mislead the financial statements' users.

If management intends to mislead the users, then the management bias is fraudulent.

Everyone has conscious and subconscious biases that affect our opinions - e.g. in how we interpret news, evaluate political candidates, or even view different cultures. In accounting, management is no different. Some people are relatively conservative, while others are more aggressive, and management styles vary from one entity to another. Some entities set internal goals or targets, whereas others are more focused on external analyst reports.

Management's nature, as well as internal and external targets or pressures, may therefore affect the extent of management bias.

What do we do when we identify indicators of management bias? [ISA | 786.1700]

When we identify indicators of management bias, including indicators of fraud, it is important that we perform additional procedures. These procedures may include:

- obtaining an understanding of management's accounting principle or policy choice when an alternate principle or policy would have been more appropriate;
- understanding the quantitative and qualitative impact to the financial statements and whether we need to propose any audit adjustments (e.g. when management accounting policy choice is not the most appropriate); and
- communicating indicators of management bias in the selection and application of accounting principles and policies to those charged with governance.

When we identify management bias during the audit, we reassess whether this bias creates a new RMM. We also reassess whether our planned identified RMMs remain appropriate and whether our audit procedures sufficiently address this bias.

The existence of management bias may lead us to identify additional RMMs, particularly fraud risks, or, more probably, lead us to assess already identified RMMs in different ways.

For audits performed under the PCAOB standards, those charged with governance for this activity are the audit committee or, if there is no audit committee, the board of directors.

How may management bias affect the selection and application of accounting principles and policies? [ISA | 786.1800]

Examples of how management bias may affect how management selects and applies accounting principles and policies - e.g. to allow them to manipulate earnings - include:

- changing the accounting principle or policy for inventory pricing between FIFO (first in, first out) / weighted average cost;
- using an accounting principle or policy that is not in line with the relevant accounting framework - e.g. using a threshold for capitalization of fixed assets that has a material effect on the financial statements; and
- interpreting an accounting standard - e.g. what costs are recorded within a restructuring charge.

What may indicate management bias in the selection and application of accounting principles and policies? [ISA | 786.1900]

Examples that suggest management was biased in selecting and applying accounting principles and policies include situations where:

- management selected and applied an accounting principle or policy that is inconsistent with industry practice;
- management voluntarily changes an accounting policy that had a material impact on profit and loss in the period and the change is not 'preferable' (i.e., it does not clearly provide reliable and more relevant information to users of the financial statements).

Examples that suggest management was biased in determining accounting estimates include situations where:

- management selected and applied a method or model to determine an accounting estimate that is inconsistent with historical practice - e.g., booking accounting estimates at the low end of a range when management historically booked to the mid-point;
- management recorded estimates that are predominately optimistic, when they were cautious in the preceding year;
- management changes the assumptions and methods used in an accounting estimate from period to period; and
- management's assumptions for fair value accounting estimates are inconsistent with observable assumptions in the marketplace.

Do we perform additional evaluation of selection and application of accounting principles and policies to address a financial statement level fraud risk? [ISA | 786.11584]

Yes. We specifically consider the nature of the financial statement level fraud risk and what that tell us about how management may seek to manipulate earnings.

> For example, we may have identified a financial statement level fraud risk related to the fact an entity is planning to do an initial public offering (IPO). Given that broad fraud risk, management may seek to select and apply certain accounting policies to maximize earnings, achieve a certain enterprise valuation or maximise the ultimate share price in an IPO transaction.
>
> Similarly, we may have identified a financial statement level fraud risk related to the fact that an entity owes contingent consideration from a recent acquisition that is determined based on three-year earnings of the newly acquired subsidiary. In this instance, management may seek to select and apply accounting policies to minimise short-term earnings to reduce the contingent consideration payable - for example, by selecting and/or applying accounting policies that overstate the fair value of assets acquired and understate the fair value of liabilities assumed to reduce future earnings when they settle.

Once we have an understanding of how management may seek to manipulate earnings, we then evaluate the selection and application of accounting policies to determine if there are indicators that management is intentionally manipulating earnings in the selection and application of accounting policies. This may include:

- assessing newly selected policies to determine whether they are appropriate. This includes considering whether there are alternatives and whether management selected the accounting policy that we believe is most appropriate. If not, asking ourselves whether their selection is

indicative of management's efforts to manipulate earnings (i.e. is the financial impact of the inappropriate aligned with management's objectives to maximise or minimise earnings)?

- assessing changes in the selection or application of accounting policies This includes considering whether these changes are indicative of management's efforts to manipulate earnings (i.e. is the financial impact of the change aligned with management's objectives to maximise or minimise earnings)?
- If we identify indicators that management is intentionally manipulating earnings, then we determine the impacts on our audit, including whether we have identified fraudulent activity, the impact it has on our assertion level fraud risks and changes necessary in our response to the risk of management override.

1.1.5 Determine whether pervasive changes to audit procedures are necessary [ISA | 787]

What do we do?

Determine whether it is necessary to make pervasive changes to the nature, timing or extent of our audit procedures to address RMMs

Why do we do this?

In some cases, we may identify financial statement level and assertion levels and that are best addressed by making pervasive changes to our audit procedures. These changes form part of our overall response and can help us respond to these risks and obtain sufficient appropriate audit evidence.

Execute the Audit

What are pervasive changes to our audit procedures? [ISA | 787.1300]

Pervasive changes are broad modifications to our audit strategy that affect the nature, timing or extent of many of our planned audit procedures. These changes represent a form of overall response we can employ to adequately address risks of material misstatement.

When might we make pervasive changes to our audit procedures? [ISA | 787.11585]

Pervasive changes can be made to address any risk of material misstatement, including both assertion-level RMMs and financial statement level risks. However, given the broad nature of the response, these changes are typically made to address financial statement level risks.

For example, if we identify deficiencies in the entity's control environment, we obtain more persuasive audit evidence from our substantive procedures, as opposed to relying on internal controls to reduce our substantive procedures.

What are examples of pervasive changes to our audit procedures? [ISA | 787.1400]

The chart below sets outs examples of pervasive changes we may make to our audit procedure.

Possible planned procedure in the absence of pervasive change:	Identified financial statement level risk:	Pervasive change:
Perform test of details, and conclude, as of an interim period, on the valuation of various assets which the entity carries at cost	Weakening economic conditions that negatively affect the value of many of the entity's assets	Alter the timing of our tests of details over the valuation of these assets so that we perform them at period-end
Plan to take a controls based approach over all areas of the audit	Pervasive weakness in the entity's risk assessment process	Don't take a controls based approach, and assess control risk at No Controls Reliance in all areas, increasing our level of substantive testing
Plan to take a controls based approach over fraud risks	Pervasive weaknesses related to tone at the top of the entity or lack of hotlines to identify and address improprieties or non-compliance with the code of conduct	Don't take a controls based approach, and assess control risk at No Controls Reliance for assertion-level RMMs due to fraud Alter the nature of our tests of details over fraud risks to obtain more persuasive evidence or additional corroborative evidence
Assess the inherent risk of RMMs related to the valuation of various assets as Base or Elevated	Significant uncertainty about the long-term demand for an entity's products based on its expansion	Assess the inherent risk of these RMMs as Significant for each asset, and increase the extent of procedures we perform

Do we always make pervasive changes to our audit procedures? [ISA | 787.1600]

We always *think* about whether to make pervasive changes to our audit procedures; however, we may sometimes conclude that none are necessary - for example, if we identified no financial statement-level risks that would have a broad impact on how we conduct the audit.

Examples

How do we identify and respond to risks that results in pervasive changes to our audit procedures? [ISA | 787.1700]

Fact pattern:

An entity's VP of Human Resources left during the year and was replaced with an external hire. The new VP of HR changed the entity's hiring policies and practices. As a result, they no longer appropriately evaluate credentials or perform background checks when hiring for accounting and financial reporting roles. The entity hired a new Corporate Controller after the change in hiring policies was instituted.

Analysis:

The engagement team concludes that there is a deficiency in the control environment. Due to its pervasive nature, it is a financial statement-level risk.

The team decides to design and implement overall responses, such as:

- involving senior members of the engagement team in executing audit procedures;
- requiring more extensive supervision and review by the engagement partner; and
- considering whether to make pervasive changes to their planned audit procedures.

They consider the pervasive impact that the control environment deficiency has on their ability to rely on internal controls, particularly those in areas of the financial statements that involve the new Corporate Controller.

The team concludes that:

- during their walkthroughs, they will inquire of process and control operators whether they have noticed a change in the tone at the top about ICFR, changes to processes, etc.;
- they will alter their control testing procedures to obtain more persuasive evidence over controls involving or overseen by the Corporate Controller; and/or
- they will alter their substantive procedures to obtain more persuasive audit evidence in areas involving or overseen by the Corporate Controller.

1.2 Apply professional skepticism [ISA | 788]

What do we do?

Apply professional skepticism in gathering and evaluating audit evidence.

Why do we do this?

Professional skepticism plays a key role in the audit and is integral to our skill set. Our due professional care requires that we exercise professional skepticism throughout the audit. Exercising professional skepticism can be particularly relevant when considering our fraud risk assessment or response to identified fraud risks because fraud often involves sophisticated and carefully organized schemes designed to conceal it.

Execute the Audit

What is professional skepticism? [ISA | 788.1300]

Professional skepticism involves having a questioning mind that critically assesses audit evidence. It includes watching out for conditions or evidence that may indicate a possible misstatement due to error or fraud.

What are examples of instances where we may apply a heightened degree of professional skepticism?

[ISA | 788.7958]

Examples of potential red flags relevant to our understanding of the entity and its environment

- A lack of clarity regarding the identity of the counterparties and the nature of their relationship to the reporting entity;
- Reliance on a small number of business partners for significant volumes of revenues or profits;
- Transactions or arrangements that lack a clear business purpose or economic substance;
- Significant operations or business activities conducted through, or assets held in, offshore jurisdictions or jurisdictions with limited regulation/transparency;
- Complex or high volumes of related party transactions;
- Financial relationships/key performance indicators (KPIs) that are inconsistent with the entity's peers or our expectations, such as: – A significant and persistent or unusual gap between profitability and operating cashflows;
- The entity holds more interest-bearing debt than appears to be necessary given its holdings of liquid financial asset; or
- The entity has significantly increased its debt to finance assets that may be challenging to obtain audit evidence with respect to the existence assertion, such as material goods in transit, loans receivable, prepayments or assets under construction
- Excessively complex contractual arrangements;
- Media coverage or analyst reports which raise concerns, such as questions about the appropriateness of the entity's business or accounting practices;
- Commentary in the entity's Other Information, e.g. MD&A, which may highlight concerns about an entity's performance and future plans; and
- The existence of significant short positions held in the entity's shares.

If any of the above are identified, we understand the facts and circumstances, including consideration of the source of the information and its reliability, in determining whether there is an impact on our identification and assessment of the RMMs.

Examples of potential red flags relevant to other aspects of the audit

- Are there unusual delays in providing requested information?
- Is documentation only available as copies or electronically transmitted documents when documents in original form are expected to exist?
- Is electronic evidence missing or unavailable, and is this inconsistent with the entity's record retention practices or policies or legal booking keeping requirements?
- Does management attempt to restrict access to records, facilities, certain employees, customers, suppliers or others from who audit evidence may be sought?
- Is there an unwillingness to provide key electronic files for testing using computer-assisted audit techniques?
- Is information frequently presented at the last minute leaving little time to appropriately verify its contents?
- Are there indications of deficient controls or less than robust governance for the size of the business?
- Do management's explanations evolve over time, which may indicate they are not being transparent or presenting the full picture?

- Are responses from management and employees arising from our inquiries or analytical procedures inconsistent, vague or implausible?
- Is management dominant and/or aggressive when dealing with external or internal auditors? Do they question why we need to perform certain procedures or push back when we seek to obtain additional corroborating audit evidence?
- Does management take an unusual interest in the selection of accounting policies, how estimates are made, or transactions are accounted for? Does management appear to be more focused on a desired outcome than on ensuring the accounting treatment is appropriate?
- Is there an unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable?
- Is management involved in making journal entries, particularly when they would not normally do so, or need to override controls in order to do so?

We do not only think about the indicators individually, but also in the aggregate. When more than one indicator is present, collectively they may indicate a pattern of collusion and concealment, which may cause us to evaluate the implications for our audit.

How do we apply professional skepticism? [ISA | 788.1400]

We apply professional skepticism by being alert to matters such as:

- audit evidence that contradicts other audit evidence we have obtained;
- information that brings into question the reliability of documents and responses to inquiries we plan to use as audit evidence; and
- conditions that may indicate possible fraud.

Professional skepticism also involves remaining alert to our biases and other circumstances that can cause us to gather, evaluate, rationalize, and recall information in a way that is consistent with client preferences rather than interests of external users throughout the audit.

We maintain professional skepticism by asking whether the information and audit evidence we gather suggests that a material misstatement due to fraud may exist.

Applying professional skepticism does not mean that we assume management is dishonest or not. Rather, we exercise professional skepticism with balance. We do not accept less persuasive evidence merely because we believe management to be honest.

What are examples of biases that may impede our ability to apply professional skepticism? [ISA | 788.1500]

Common biases that can undermine professional skepticism and ways to mitigate them include:

Bias/trap and potential impact:	Ways to mitigate:
Rush-to-solve trap The tendency due to time pressures to want to solve a problem by making a quick judgement. Potential impact	• Awareness • Plan your audit to allow sufficient time for the performance and appropriate review of audit procedures • Document work performed routinely and in a timely manner to facilitate critical thinking and capture a

Can lead to a limited understanding of a problem or alternative resulting in inappropriate conclusions.	more accurate and complete reflection of how the conclusions were reached • Start working on the key decisions early in the process
Availability bias The tendency to place more weight on events or experiences that immediately come to mind or are readily available than on those that are not. Potential impact Can lead to limited alternatives considered or evidence gathered related to those alternatives	• Awareness • Consider why something comes to mind • Vividness • Recent events • Make the opposing case • Seek advice from others • Obtain and consider objective data
Overconfidence bias The tendency to overestimate one's own ability to make accurate assessment of risks or other judgements or decisions. Potential impact Can lead to underinvesting in understanding issues, insufficient challenging of management views or limited consideration of potential alternatives.	• Awareness • Challenge management's estimates and: - Ask about potential causes of unexpected outcomes - Ask for estimate or likelihood of unexpected outcomes • Challenge extremely high or low estimates • Maintain professional skepticism
Confirmation bias The tendency to seek confirming information or to favor conclusions that are consistent with initial beliefs. Potential impact Can lead to only seeking evidence that is consistent with a client's explanation or a preferred outcome.	• Awareness • Consider alternatives provided by others or yourself • Seek disconfirming or more complete information • Explicitly acknowledge and consider your preferences or motives
Anchoring bias	• Awareness • Make an independent judgement or estimate void of an anchor

The tendency to make assessments in evaluating information by starting with an initial value and then adjusting sufficiently away from initial value in forming a final judgment. Potential impact Can lead to a lack of objectivity in assessing transactions, estimates and account balances.	• Solicit input from others, being careful not to provide anchor for their thinking • Take steps to make judgements or formulate expectations prior to seeing preliminary outcomes • Obtain benchmarking information
Groupthink The tendency to think or make decisions as a group that discourages creativity or individual responsibility. Potential impact Can lead to limited alternatives considered or evidence gathered related to those alternatives.	• Awareness • Communicate individual opinions and thoughts • Encourage others to communicate their opinions and thoughts
Automation bias The tendency to favor output generated from automated systems, even when human reasoning or contradictory information raises questions as to whether such output is reliable or fit for purpose. Potential impact Can lead to inappropriate reliance on information.	• Awareness • Involve specific team members with expertise in IT

What are examples of additional impediments on exercising professional skepticism? [ISA | 788.157463]

Additional examples include but are not limited to:

Impediments	Potential impact
Budget constraints	Discourage the use of sufficiently experienced or technically qualified resources for the effective

	understanding, assessment of and responses to risks and informed questioning of management.
Tight deadlines	Negatively affect the behavior of those who perform the work as well as those who direct, supervise and review. For example, external time pressures may create restrictions to analyze complex information effectively.
Lack of cooperation or undue pressures imposed by management	Negatively affect the engagement team's ability to resolve complex or contentious issues.
Insufficient understanding of the entity and its environment, its system of internal control and the applicable financial reporting framework	Constrain the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions.
Difficulties in obtaining access to records, facilities, certain employees, customers, vendors or others	Cause us to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible.
Overreliance on automated tools and techniques	Result in the engagement team not critically assessing audit evidence.

What are possible actions that we can take to mitigate impediments in applying professional skepticism?

[ISA | 788.157464]

Possible actions to mitigate impediments may include:

- Remaining alert to changes in the nature or circumstances of the audit engagement that necessitate additional or different resources for the engagement, and requesting additional or different resources from those individuals within the firm responsible for allocating or assigning resources to the engagement.
- Explicitly alerting the engagement team to instances or situations when vulnerability to unconscious or conscious auditor biases may be greater (e.g. areas involving greater judgment) and emphasizing the importance of seeking advice from more experienced members of the engagement team in planning and performing audit procedures.
- Changing the composition of the engagement team, for example, requesting that more experienced individuals with greater skills or knowledge or specific expertise are assigned to the engagement.
- Involving more experienced members of the engagement team when dealing with members of management who are difficult or challenging to interact with.

- Involving specific team members or KPMG specialists to assist the engagement team with complex or subjective areas of the audit.
- Modifying the nature, timing and extent of direction, supervision or review by involving more experienced engagement team members, more in-person oversight on a more frequent basis or more in-depth reviews of certain working papers for:
  - Complex or subjective areas of the audit;
  - Areas that pose risks to achieving quality on the audit engagement;
  - Areas with a fraud risk; and
  - Identified or suspected instance of non-compliance with laws or regulations, including illegal acts.
- Setting expectations for:
  - Less experienced members of the engagement team to seek advice frequently and in a timely manner from more experienced engagement team members or the engagement partner; and
  - More experienced members of the engagement team to be available to less experienced members of the engagement team throughout the audit engagement and to respond positively and in a timely manner to their insights, requests for advice or assistance.
- Communicating with those charged with governance when management imposes undue pressure or the engagement team experiences difficulties in obtaining access to records, facilities, certain employees, customers, vendors or others from whom audit evidence may be sought.

What is contradictory, or disconfirming audit evidence? [ISA | 788.11474]

Contradictory, or disconfirming audit evidence is evidence obtained in the audit that seems to contradict the evidence on which we based our original risk assessments (and in some cases, the amount or disclosure being audited). We may come across contradictory audit evidence while performing procedures on a specific account balance, or in an unrelated manner.

> Example: Contradictory audit evidence may exist in the form of information that an entity is insolvent, and therefore it may not be able to repay the outstanding accounts receivables balance, and the client has not created an allowance for doubtful accounts related to this receivable. The evidence is "contradictory" because it contradicts the client's premise, i.e. that the amount is collectible and no allowance is necessary.

Who is responsible for applying professional skepticism? [ISA | 788.1600]

It is the responsibility of each individual involved in the engagement to appropriately apply professional skepticism throughout the audit, including when identifying and assessing risks of material misstatement (RMMs), including RMMs due to fraud - i.e., fraud risks, performing tests of controls and substantive procedures to respond to identified RMMs, and evaluating the results of the audit.

The engagement partner is responsible for setting an appropriate tone that promotes:

- emphasizing the importance of each engagement team member to exercise and maintain a questioning mind throughout the audit; and
- exercising professional skepticism in gathering and evaluating audit evidence.

When do we apply professional skepticism? [ISA | 788.1700]

We apply professional skepticism throughout the audit, including when we respond to RMMs, particularly fraud risks. We apply professional skepticism particularly when we:

- perform engagement acceptance or continuance, including evaluating the integrity of management;
- identify and assess RMMs;
- design and perform audit procedures to address RMMs, including the nature, timing and extent of our audit procedures;
- evaluate management judgments; and
- determine our overall conclusion on the audit evidence obtained.

Why do we apply professional skepticism when responding to fraud risks? [ISA | 788.1800]

Applying professional skepticism can be particularly relevant when responding to fraud risks as it enhances the effectiveness of our audit procedures. We also reduce the risk that we may:

- overlook unusual transactions or circumstances;
- misinterpret audit results and reach the wrong conclusion; and
- use inappropriate assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results.

How do we apply professional skepticism when we review documents and records? [ISA | 788.1900]

When we review documents and records, we apply professional skepticism by considering their reliability, as fraud, including fraudulent financial reporting and misappropriation of assets, is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization. We may accept records and documents as genuine unless we have a reason to believe the contrary.

If we doubt the reliability of information or find indications of possible fraud - e.g. if conditions identified during the audit lead us to believe that a document is inauthentic or its terms have been falsified - we investigate further and determine whether to modify or add new audit procedures to resolve the matter.

> For example, when designing our response to an assessed RMM related to the risk of management override of controls, we inspect a selection of manual journal entries that have certain characteristics that could indicate a higher risk of fraud. If we examine the supporting documentation for those entries and find them vague or unclear, we apply professional skepticism by obtaining more persuasive audit evidence - e.g. from a third party - before we conclude whether fraud is indicated, rather than by obtaining other potentially less reliable internal evidence or inquiry alone.

To what extent do we rely on representations from management? [ISA | 788.11475]

As part of evaluating audit results, we conclude on whether sufficient appropriate audit evidence has been obtained to support the opinion on the financial statements. In order to accomplish this, we do not simply rely on explanations from management or those charged with governance. A common pitfall of auditors is to 'audit by conversation', which means to obtain evidence merely from discussions

with the entity's representatives, without appropriate audit evidence; this does not display professional skepticism. Instead, we don't just accept the entity's explanation but seek to obtain appropriately persuasive audit evidence.

Representations from management or those charged with governance are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base our audit opinion(s).

What conditions may cause us to believe that a document may be inauthentic or has been modified? [ISA | 788.11476]

The following conditions may cause us to believe that a document may be inauthentic or has been modified:

- significant delays in management providing requested documents;
- evidence of alterations to documents;
- documents missing signatures or that are incomplete;
- discrepancies in accounting records and documents; or
- conflicting or missing documents.

How do we "investigate further", if we identify conditions that cause us to believe that a document may not be authentic or has been modified? [ISA | 788.11477]

When we identify conditions that cause us to believe that a document may not be authentic, that terms in a document have been modified but not disclosed to us, or that undisclosed side agreements may exist, we perform procedures to further investigate such as:

- confirming directly with the third party; and
- using the work of a KPMG specialist to assess the authenticity of a document

An audit rarely involves the authentication of documents, nor are we trained as, or expected to be, an expert in such authentication.

How do we demonstrate our professional skepticism? [ISA | 788.2000]

We demonstrate our professional skepticism by maintaining the proper mindset and evidencing our application of professional skepticism throughout the audit and our audit documentation.

For example, we can evidence our professional skepticism by documenting:

- our revisions to risk assessment as a result of identified disconfirming evidence;
- significant decisions reached by the engagement team;
- our additional questions in response to inquiries and other information obtained from management and those charged with governance;
- how we incorporate unpredictability in our audit plan;
- how we evaluate disconfirming evidence and the impact to the audit, including changes in our audit strategy; and
- how we evaluate the reasonableness of management assumptions and challenge those assumptions.

Examples

How do we respond to contradictory or disconfirming audit evidence? [ISA | 788.11488]

Fact pattern

ABC Company recorded accounts receivable from its customer, XYZ Company, in the amount of CU1 million. This balance has been confirmed with the customer. The balance is past due by over 90 days, and no allowance for doubtful accounts has been recorded. Unrelated to our audit procedures, the engagement team comes across an article in the news that indicates that XYZ Company may become insolvent.

Analysis

The engagement team does not ignore this information, but questions ABC Company as to why the allowance for doubtful accounts does not include a provision for this customer. If ABC Company provides a plausible explanation, then the engagement team does not rely on the explanation, but investigates further and seeks objective evidence. For example, if ABC Company says that they know XYZ Company well, and have a longstanding relationship with them, and know they are committed to paying the amount, the engagement team documents the conversation and then seeks objective evidence. The evidence the team finds may either confirm (support) the entity's position, such as appropriately sourced subsequent payments on account, or contradict the entity's position, such as no subsequent payments, downgraded credit ratings or other media coverage that are an indication that the customer may not be able to pay.

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

International Standards on Auditing: ISA 330.06-07

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

6. The auditor shall design and perform 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. (Ref: Para. A4-A8; A43-A54)

7. In designing the further audit procedures to be performed, the auditor shall:

(a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each significant class of transactions, account balance, and disclosure, including:

(i) The likelihood and magnitude of misstatement due to the particular characteristics of the significant class of transactions, account balance, or disclosure (that is, the inherent risk); and

(ii) Whether the risk assessment takes account of controls that address the risk of material misstatement (that is, the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor plans to

test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and (Ref: Para. A9-A18)

(b) Obtain more persuasive audit evidence the higher the auditor's assessment of risk. (Ref: Para. A19)

ISA Application and Other Explanatory Material: ISA 330.A4-A19

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

The Nature, Timing and Extent of Further Audit Procedures (Ref: Para. 6)

A4. The auditor's assessment of the identified risks of material misstatement at the assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, the auditor may determine that:

(a) Only by performing tests of controls may the auditor achieve an effective response to the assessed risk of material misstatement for a particular assertion;

(b) Performing only substantive procedures is appropriate for particular assertions and, therefore, the auditor excludes the effect of controls from the assessment of the risk of material misstatement. This may be because the auditor has not identified a risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence and therefore is not required to test the operating effectiveness of controls. Therefore, the auditor may not plan to test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures; or

(c) A combined approach using both tests of controls and substantive procedures is an effective approach.

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. However, as required by paragraph 18, irrespective of the approach selected and the assessed risk of material misstatement, the auditor designs and performs substantive procedures for each material class of transactions, account balance, and disclosure.

A5. The nature of an audit procedure refers to its purpose (that is, test of controls or substantive procedure) and its type (that is, inspection, observation, inquiry, confirmation, recalculation, reperformance, or analytical procedure). The nature of the audit procedures is of most importance in responding to the assessed risks.

A6. Timing of an audit procedure refers to when it is performed, or the period or date to which the audit evidence applies.

A7. Extent of an audit procedure refers to the quantity to be performed, for example, a sample size or the number of observations of a control.

A8. 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 provides a clear linkage between the auditor's further audit procedures and the risk assessment.

Responding to the Assessed Risks at the Assertion Level (Ref: Para. 7(a))

Nature

A9. ISA 315 (Revised 2019) requires that the auditor's assessment of the risks of material misstatement at the assertion level is performed by assessing inherent risk and control risk. The auditor assesses inherent risk by assessing the likelihood and magnitude of a misstatement taking into account how, and the degree to which the inherent risk factors affect the susceptibility to misstatement of relevant assertions.[107] The auditor's assessed risks, including the reasons for those assessed risks, may affect both the types of audit procedures to be performed and their combination. For example, when an assessed risk is high, the auditor may confirm the completeness of the terms of a contract with the counterparty, in addition to inspecting the document. Further, certain audit procedures may be more appropriate for some assertions than others. For example, in relation to revenue, tests of controls may be most responsive to the assessed risk of material misstatement of the completeness assertion, whereas substantive procedures may be most responsive to the assessed risk of material misstatement of the occurrence assertion.

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107 ISA 315 (Revised 2019), paragraphs 31 and 34

A10. The reasons for the assessment given to a risk are relevant in determining the nature of audit procedures. For example, if an assessed risk is lower because of the particular characteristics of a class of transactions without consideration of the related controls, then the auditor may determine that substantive analytical procedures alone provide sufficient appropriate audit evidence. On the other hand, if the assessed risk is lower because the auditor plans to test the operating effectiveness of controls, and the auditor intends to base the substantive procedures on that low assessment, then the auditor performs tests of those controls, as required by paragraph 8(a). This may be the case, for example, for a class of transactions of reasonably uniform, non-complex characteristics that are routinely processed and controlled by the entity's information system.

Timing

A11. The auditor may perform tests of controls or substantive procedures at an interim date or at the period end. The higher the risk of material misstatement, the more likely it is that the auditor may decide it is more effective to perform substantive procedures nearer to, or at, the period end rather than at an earlier date, or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis). This is particularly relevant when considering the response to the risks of fraud. For example, the auditor may conclude that, when the risks of intentional misstatement or manipulation have been identified, audit procedures to extend audit conclusions from interim date to the period end would not be effective.

A12. On the other hand, performing audit procedures before the period end may assist the auditor in identifying significant matters at an early stage of the audit, and consequently resolving them with the assistance of management or developing an effective audit approach to address such matters.

A13. In addition, certain audit procedures can be performed only at or after the period end, for example:

- Agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers;
- Examining adjustments made during the course of preparing the financial statements; and
- Procedures to respond to a risk that, at the period end, the entity may have entered into improper sales contracts, or transactions may not have been finalized.

A14. Further relevant factors that influence the auditor's consideration of when to perform audit procedures include the following:

- The control environment.
- When relevant information is available (for example, electronic files may subsequently be overwritten, or procedures to be observed may occur only at certain times).
- The nature of the risk (for example, if there is a risk of inflated revenues to meet earnings expectations by subsequent creation of false sales agreements, the auditor may wish to examine contracts available on the date of the period end).
- The period or date to which the audit evidence relates.
- The timing of the preparation of the financial statements, particularly for those disclosures that provide further explanation about amounts recorded in the statement of financial position, the statement of comprehensive income, the statement of changes in equity or the statement of cash flows.

Extent

A15. The extent of an audit procedure judged necessary is determined after considering the materiality, the assessed risk, and the degree of assurance the auditor plans to obtain. When a single purpose is met by a combination of procedures, the extent of each procedure is considered separately. In general, the extent of audit procedures increases as the risk of material misstatement increases. For example, in response to the assessed risk of material misstatement due to fraud, increasing sample sizes or performing substantive analytical procedures at a more detailed level may be appropriate. However, increasing the extent of an audit procedure is effective only if the audit procedure itself is relevant to the specific risk.

A16. The use of computer-assisted audit techniques (CAATs) may enable more extensive testing of electronic transactions and account files, which may be useful when the auditor decides to modify the extent of testing, for example, in responding to the risks of material misstatement due to fraud. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, or to test an entire population instead of a sample.

Considerations specific to public sector entities

A17. For the audits of public sector entities, the audit mandate and any other special auditing requirements may affect the auditor's consideration of the nature, timing and extent of further audit procedures.

Considerations specific to smaller entities

A18. In the case of very small entities, there may not be many control activities that could be identified by the auditor, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform further audit procedures that are primarily substantive procedures. In some rare cases, however, the absence of controls or of

components of the system of internal control may make it impossible to obtain sufficient appropriate audit evidence.

Higher Assessments of Risk (Ref: Para. 7(b))

A19. When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Design and perform procedures to address each RMM [ISA | 587]

What do we do?

Design and perform audit procedures whose nature, timing and extent address the risks of material misstatement for each assertion of each significant account and disclosure and in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory

Why do we do this?

To meet our audit objectives, we reduce audit risk to an appropriately low level by obtaining persuasive - i.e. sufficient and appropriate - audit evidence.

To reduce audit risk, we design and perform audit procedures for each RMM for each significant account, disclosure and relevant assertions. When designing and performing these audit procedures, we can take a controls based approach or a substantive approach for each RMM.

If we are biased when we design and perform our audit procedures, then we may fail to obtain sufficient and appropriate audit evidence and draw the wrong conclusions on which we base our audit opinion.

Execute the Audit

What is our objective when performing a financial statement audit? [ISA | 587.1400]

Our audit objective is to provide reasonable assurance that the financial statements are free of material misstatement (whether due to error or fraud). We accomplish this audit objective by reducing audit risk to an appropriately low level.

What is audit risk? [ISA | 587.1500]

Simply stated, audit risk is the possibility that we will reach the wrong overall conclusion in our audit - i.e. that we express an unqualified audit opinion when the financial statements are materially misstated.

What are the components of audit risk? [ISA | 587.10999]

Audit risk has two primary components.

Risk of material misstatement	The risk that the financial statements are materially misstated	Exists independently of the audit
Detection risk	The risk that our audit procedures fail to detect that material misstatement	Influenced by what we do in the audit

How do we reduce audit risk to an appropriately low level? [ISA | 587.1600]

To reduce audit risk to an appropriately low level, we design and perform audit procedures to obtain persuasive evidence over each risk of material misstatement identified. We design and perform these procedures in a manner that is not biased towards obtaining corroborative audit evidence or towards excluding contradictory audit evidence.

We maintain professional skepticism when evaluating audit evidence with respect to the RMM, including when:

- considering information that may be used as audit evidence (corroborative or contradictory), and
- what procedures would be appropriate in the circumstances.

What do we consider when designing our audit procedures? [ISA | 587.11161]

When we design our audit procedures, we consider:

- the type, likelihood, and magnitude of potential misstatements that may result from the identified risks (i.e. inherent risk);
- whether we intend to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures (i.e. control risk); and
- the persuasiveness of evidence we need, based on our risk assessment.

What is persuasive evidence? [ISA | 587.1900]

Persuasive evidence is evidence that makes a more credible argument or strengthens our 'belief' in the results of our testing. To be persuasive, the evidence has to be sufficient (i.e. quantity) and appropriate (i.e. quality) audit evidence. Some types of evidence we gather are more persuasive than others. We may calibrate the level of audit evidence we plan to obtain by altering the nature, timing and/or extent of our audit procedures.

How do we assess risk for assertion-level RMMs? [ISA | 587.2000]

Our assessment of the risk for assertion-level RMMs is a function of two separate components - inherent risk and control risk. We call this assessment combined assessed risk (CAR).

We assess CAR for each identified assertion-level RMM.

Our CAR assessment influences the substantive procedures we design and perform to reduce detection risk to the appropriate level, and therefore reduce audit risk.

What is inherent risk? [ISA | 587.11000]

Inherent risk is the susceptibility of an assertion to a misstatement that may be material, before considering related control activities.

For example, consider the inherent risk of having an accident while driving. We most likely assess the risk of city driving as higher than the risk of driving on the freeway or motorway. This is because city driving has many different hazards - e.g. lots of pedestrians and other cars - whereas a freeway may have fewer hazards - i.e. it's an open road with few other cars.

When thinking about the inherent risk, we do not consider the potential controls in place, such as speed limits, road signs, and stop lights.

The same concept applies to auditing - certain accounts, disclosures and assertions are inherently riskier than others are. Inherent risk may be greater when transactions are complex, or in situations that include estimates with a high degree of uncertainty.

What is control risk? [ISA | 587.11001]

Control risk is the risk that an entity's controls will fail to prevent or detect a material misstatement on a timely basis. Control risk is lower when the controls associated with a particular assertion are designed and operating effectively.

Essentially, control risk relates to how effective the controls are in reducing audit risk - in the same way that effective speed limits, road signs and stop lights can reduce the risk of having an accident while driving.

Similar to inherent risk, control risk exists independent of the audit. But unlike inherent risk, control risk is something that management can influence: the stronger an entity's controls over financial reporting, the lower control risk becomes.

However, while the strength of an entity's controls can have an impact on audit risk, we only factor that into our assessment of CAR when we obtain sufficient evidence over the design, implementation and operating effectiveness of the relevant control activities.

Due to the inherent limitations of internal control - e.g. human error or management override - some control risk will always exist.

What is the CAR matrix? [ISA | 587.2100]

The CAR matrix provides our CAR assessment, based on our individual assessments of inherent risk and control risk for each assertion-level RMM.

	Control risk (CR)	
Inherent risk (IR)	No Controls Reliance (N)	Controls Reliance (C)
Significant (S)	**SN**	**SC**
Elevated (E)	**EN**	**EC**
Base (B)	**BN**	**BC**

How does persuasive evidence relate to CAR? [ISA | 587.2200]

We gather more persuasive audit evidence for those RMMs that have a higher CAR (i.e. EN, EC, SN, SC).

We may calibrate the level of audit evidence we plan to obtain by altering the nature, timing and/or extent of our tests of controls or substantive procedures.

What types of audit procedures can we design? [ISA | 587.2400]

In a financial statement audit, our procedures may include tests of controls - i.e. testing their operating effectiveness - and/or substantive procedures.

Effective controls allow us to alter the nature, timing and extent of substantive procedures. This allows us to obtain evidence that is less persuasive than we planned to obtain had we not tested controls and found them effective.

In some cases, we may decide that substantive procedures alone are the most appropriate audit response - for example, because:

- our risk assessment procedures did not identify relevant process control activities over the process risk points related to the RMM; or
- testing controls is inefficient.

In such cases, we may not rely on the operating effectiveness of controls to determine the nature, timing and extent of substantive procedures.

Tests of controls alone provide insufficient evidence to conclude on an RMM. Even when we plan to test controls, we still perform substantive procedures for each RMM.

The combination of substantive procedures and tests of controls, including the nature, timing and extent of those tests, may differ for each RMM.

1.1 Make a preliminary CAR assessment for each RMM [ISA | 588]

What do we do?

Assess, preliminarily, the assessed level of risk for each risk of material misstatement in accordance with the CAR matrix

Why do we do this?

We make a preliminary assessment of combined assessed risk (CAR) for each risk of material misstatement (RMM) based on our expected control risk (Controls Reliance or No Controls Reliance) and inherent risk. This helps us design both procedures to test controls (if applicable) and substantive procedures.

We reassess CAR after we complete our tests of controls (if applicable) and throughout the audit.

Execute the Audit

What is combined assessed risk? [ISA | 588.1300]

Our assessment of the level of assertion-level RMMs is a function of two separate components - inherent risk and control risk. We call this assessment 'combined assessed risk', or CAR.

We assess CAR for each identified assertion-level RMM.

Our CAR assessment influences the substantive procedures we design and perform to reduce detection risk to the appropriate level, and therefore reduce audit risk.

Why does the CAR assessment matter? [ISA | 588.1400]

If we don't adequately assess CAR, our substantive procedures may not obtain sufficient evidence to support our audit opinion. The CAR assessment helps us design our substantive procedures so we obtain sufficient appropriate audit evidence, considering the level of risk for a particular RMM.

As our CAR assessment increases (i.e. we get to the EN/EC or SN/SC level), we modify the nature, timing and extent of our substantive audit procedures to obtain more persuasive audit evidence.

When do we make a preliminary CAR assessment? [ISA | 588.1500]

We make a preliminary CAR assessment for each assertion-level RMM after we have obtained an understanding of the entity, including its internal controls over financial reporting.

This preliminary CAR assessment occurs before we plan our audit procedures (including our tests of operating effectiveness of the relevant controls).

How do we make our preliminary CAR assessment? [ISA | 588.1600]

We base our preliminary CAR assessment for each RMM on our assessed inherent risk and expected control risk.

We assess inherent risk as part of identifying and assessing the RMM. Our preliminary assessment of control risk is based on whether:

- we expect to rely on controls by testing the operating effectiveness of relevant controls to reduce our substantive procedures (Controls Reliance); or
- we will not rely on controls to reduce our substantive procedures (No Controls Reliance) because the controls are missing, we do not expect them to be effective or because we will not test their operating effectiveness.

Our preliminary CAR assessment will be one of the six levels listed in the following matrix.

	Control risk (CR)	
Inherent risk (IR)	**No Controls Reliance (N)**	**Controls Reliance (C)**
Significant (S)	**SN**	**SC**
Elevated (E)	**EN**	**EC**
Base (B)	**BN**	**BC**

Risk level increases

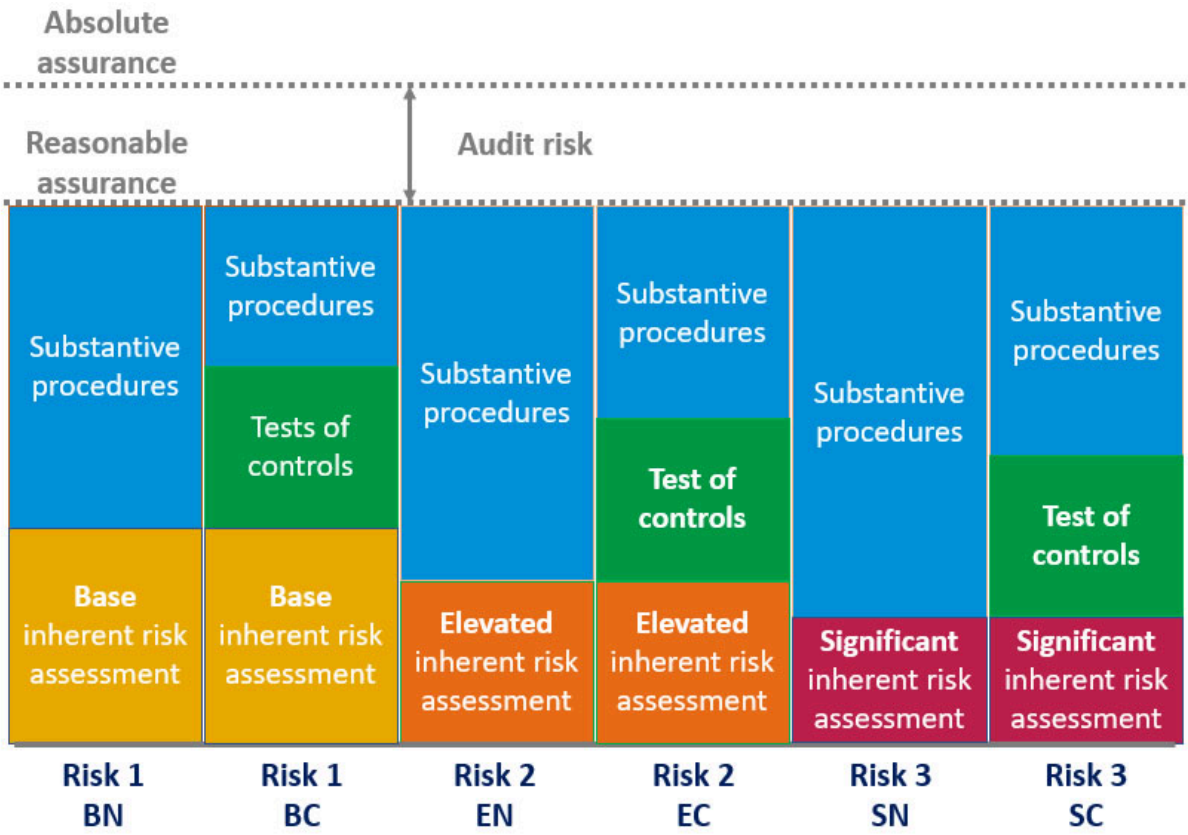
How does our preliminary CAR assessment affect our substantive procedures? [ISA | 588.1700]

Our preliminary CAR assessment helps us design the nature, timing and extent of our substantive procedures.

We cannot influence the inherent risk assessment related to an RMM.

We may change our control risk assessment — i.e. Controls Reliance or No Controls Reliance — but only by deciding to test the operating effectiveness of controls, and finding them to be designed and operating effectively. However, we cannot influence whether or not the entity's controls are designed and operating effectively.

The graphic below shows how the different elements of our CAR assessment fit together and affect how much evidence we obtain. As our inherent risk assessment increases or decreases (and control risk is constant), the cumulative evidence we plan to obtain from our substantive procedures also increases or decreases, respectively.



For what period of time do we make a CAR assessment? [ISA | 588.1800]

We generally make a single CAR assessment for each RMM for the entire audit period. But sometimes our CAR assessment may vary for different portions of the audit period.

This situation generally arises when we intend to test and rely on controls to reduce control risk for only part the audit period - that is, when the period of reliance is less than the full period we are auditing - for example, when an entity implements new controls or remediates deficient controls during an audit period.

When do we reassess our preliminary CAR assessment? [ISA | 588.1900]

We reassess CAR throughout the audit engagement as we obtain new information or conclude on procedures.

> Suppose the engagement team initially plan to rely on controls related to a specific RMM. When they test the operating effectiveness of these controls, they identify some controls that did not operate effectively, and that there were no compensating controls at a level sufficient to reduce control risk. In this case, they cannot assess control risk at Controls Reliance.
>
> When they change their assessment of control risk to No Controls Reliance, the CAR assessment changes accordingly. As a result, they modify their planned substantive procedures to reflect the change in CAR and the level of evidence necessary.
>
> Further, as they perform those substantive procedures, they may identify changes in the factors used to assess inherent risk.

Overall, as we obtain evidence throughout the audit, we determine whether it supports our preliminary CAR assessment or if not, to re-evaluate it.

1.2 Design and perform substantive procedures for each RMM [ISA | 1287]

What do we do?

Design and perform substantive procedures for each risk of material misstatement

Why do we do this?

We perform substantive procedures because testing controls does not provide sufficient appropriate audit evidence on its own. Internal controls have inherent limitations including management override and therefore do not provide sufficient appropriate audit evidence on their own.

We perform substantive procedures for each RMM, and not just for an assertion broadly, because there may be multiple risks, or types of potential misstatements, that relate to the same assertion. If we do not assess and respond to the risks at a granular level (i.e., the RMM level), we may not fully understand how that assertion may be misstated and address those risks appropriately in the audit.

Execute the Audit

What are substantive procedures? [ISA | 1287.1300]

Substantive procedures are audit procedures designed to detect material misstatements at the assertion level and involve testing whether the significant accounts and disclosures are in conformity with the applicable financial reporting framework. Substantive procedures include:

- tests of details, and
- substantive analytical procedures (see chapter on 'substantive analytical procedures' (AS 2305, ISA 520, AU-C 520).

Do we design and perform separate substantive procedures for each RMM? [ISA | 1287.10554]

No, we may design substantive procedure to obtain audit evidence over multiple RMMs and therefore not design and perform separate substantive procedures for each RMM.

> For example, when we test a population of revenue transactions, we may be able to design the procedure to obtain audit evidence over the date control transfers and whether there are multiple elements that are accounted for separately.

However, if the same substantive procedure is designed to address multiple RMMs, there is a clear linkage to each RMM.

> For example, during the planning phase of the audit, we identify the following two RMMs that affect the Existence and Occurrence assertion:

- the entity does not appropriately determine whether revenue is recognized at a point in time or over time; and
- For performance obligations satisfied over time, an inappropriate amount is estimated and recorded for revenue.

During the audit, we perform substantive procedures to address the first RMM only.

Because we did not perform procedures to address the second RMM, an RMM has gone unaddressed in our audit.

We also think about whether the procedure directly addresses the RMM(s) and not just the significant account or disclosure. If our substantive procedures do not appropriately address all the identified RMMs, our procedures will not provide us sufficient appropriate audit evidence that is relevant or helpful to reaching a conclusion.

For example, we identify an RMM related to the provision for doubtful debts is inappropriate as management has not completely identified receivables that are uncollectible.

As part of our substantive procedures, we confirm the balance owed directly with a sample of customers. But just because the customer has acknowledged the balance owed, doesn't mean we have obtained evidence that they can or will pay that balance.

In this case, the procedure we performed relates to the same significant account as the RMM but not to the RMM itself.

How do we design and perform substantive procedures for each RMM? [ISA | 1287.1500]

To design and perform substantive procedures for each assertion level RMM we perform the following activities:

- Design and perform substantive procedures to respond to the level of CAR
- Design and perform substantive procedures related to the period-end financial reporting process
- Evaluate our risk assessment and modify planned substantive procedures for contradictory evidence
- Perform minimum expected substantive procedures for identified RMMs
- Consider performing a dual purpose test

Are there RMMs where we may not design and perform substantive procedures? [ISA | 1287.10555]

Yes. When responding to RMMs related to data used in estimates, there may be situations where we do not design and perform substantive procedures (see activity 'Evaluate the data used in the entity's estimation process').

1.2.1 Design and perform substantive procedures to respond to the level of CAR [ISA | 1288]

What do we do?

Design and perform substantive procedures to respond to the level of combined assessed risk of the risk of material misstatement

Why do we do this?

As the combined assessed risk (CAR) of the assertion level risk of material misstatement (RMM) increases, we tailor our substantive procedures to increase the persuasiveness of the audit evidence that we obtain.

This helps us obtain sufficient appropriate audit evidence to support our audit opinion.

Execute the Audit

How do we design and perform substantive procedures to respond to the level of CAR? [ISA | 1288.1300]

We design and perform substantive procedures (or alternative procedures) to respond to the level of CAR by performing the following activities:

- Design and perform substantive procedures whose nature is responsive to CAR ;
- Design and perform substantive procedures whose timing is responsive to CAR ;
- Design and perform substantive procedures whose extent is responsive to CAR ;
- Define the population and items to be tested, including what constitutes misstatements/errors .

When applicable we break the procedure into smaller 'steps' to apply to each item to be tested, the population as a whole or a combination of both.

> For example, we are performing a cash balance offset test of details to respond to the RMM related to the presentation of cash balances in the balance sheet (i.e., whether cash overdrafts are inappropriately offset). The population to be tested is detail of cash balances and the item to be tested is a cash and cash equivalent item with a credit balance.
>
> The steps to perform are as follows:
>
> - For the population as a whole, examine the list for any cash and cash equivalent accounts with a credit (overdraft) general ledger balance or loan borrowing or debt accounts with a debit general ledger balance.
> - Evaluate whether there are accounts with positive balances at the same bank and consider whether the entity has the right to offset the cash overdraft or loan balance among the accounts.
> - If there is a right to offset and the total amount of other accounts with positive balances with the same bank is less than the cash overdraft and/or loan balance, trace the net overdraft balance to the liability recorded in the general ledger.

What is "nature, timing and extent" of substantive procedures?

The table below explains the terms nature, timing and extent of substantive procedures and provides an example of each:

Element	Explanation	Example

Nature	Type of audit procedure we perform.	A substantive analytical procedure such as a ratio analysis or a predictive analysis; or a test of details such as inspection, external confirmation, recalculation or reperformance.
Timing	When we obtain the evidence about the (RMM); and what period of time our audit procedures apply to.	An interim date (and roll forwards) - i.e. a point in time prior to period-end - or at period-end.
Extent	How extensively we perform a procedure, or the quantity of items that are subject to testing. Although we may logically equate extent with the number of items we select, extent can also be impacted by how we design our test (e.g., the precision of a SAP, sampling technique employed).	The number of sample items we subject to testing or testing all items (100%). Changing the precision of a SAP by making it more detailed.

What are 'alternative procedures'? [ISA | 1288.1400]

Alternative procedures are specific substitutes to the originally designed procedure that:

- Achieve the same objective as the original planned test, and;
- Provide sufficient appropriate audit evidence over that audit objective.

Alternative procedures are only performed when the planned audit procedures can't be completed.

> For example, if we are testing existence and accuracy of trade receivables via confirmations, and set the sample item as the total customer balance. In the case we do not receive a confirmation from the customer, despite multiple attempts, a suitable alternative procedure may be to agree all the individual invoices within the customer balance to shipping documents and subsequent cash receipts.

1.2.1.1 Design and perform substantive procedures whose nature is responsive to CAR [ISA | 1289]

What do we do?

Design and perform substantive procedures whose nature is based on and responsive to the combined assessed risk of the risk of material misstatement.

Why do we do this?

The persuasiveness of evidence obtain varies based on the nature of the audit procedures. This is because not all audit procedures are equal and some provide more persuasive audit evidence than others. Adjusting the nature of our procedures is one way to increase the persuasiveness of evidence commensurate with an increased level of combined assessed risk (CAR).

Although we may choose to perform several different types of substantive procedures, not all of them are appropriate in every circumstance. Our procedures are only effective when they are responsive to the RMM they are addressing and the types of potential misstatements that could result from those risks.

Execute the Audit

How do we design and perform substantive procedures whose nature is based on and responsive to the CAR of the RMM? [ISA | 1289.1400]

To design and perform substantive procedures whose nature is based on and responsive to the CAR of the RMM, we think about:

- the type of procedure;
- the source of the evidence the procedure provides - e.g. evidence obtained from a knowledgeable source that is independent of the entity may be more persuasive than evidence obtained only from sources internal to the entity;
- the nature of the RMM - i.e. how a misstatement could occur;
- the population and the types of transactions that the procedure covers e.g. substantive analytical procedures (SAPs) may be more effective when dealing with RMMs related to accounts that contain large volumes of transactions with a pattern of being predictable over time.
- whether the procedure is designed to address RMM(s) related to balance sheet accounts, income statement accounts or both;
- the assertions to which the RMM is linked - e.g. tests of details may be more responsive to the Existence and/or Accuracy assertions; and
- the specific objective of the procedure.

For example, when we have assessed inherent risk of RMMs associated with the existence of a prepaid asset as base, the nature of our procedures might simply include inspecting supporting documentation for transactions selected that we obtain from the entity to evaluate whether:

(1) the amount is capitalizable,
(2) the right amount was capitalized, and
(3) the amortization and current carrying value are appropriate.

However, if we have assessed the inherent risk as elevated or significant (perhaps because the asset is unusual and the contract with the counterparty is unclear), then we may also communicate directly with the counterparty or the entity's legal counsel to understand the contract terms, thus altering the nature of our procedures to respond to the risk.

What audit procedures may we perform to obtain sufficient appropriate audit evidence? [ISA | 1289.1300]

The table below describes the audit procedures that we may perform and the factors we think about when obtaining sufficient appropriate audit evidence:

Audit procedure	What is it?	Example
Inspection	Involves an examination (being physically present or using remote observation tools) of an asset or an examination of records or documents (internal and external) on paper, in electronic or other media. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.	Inspection of records, using manual or automated techniques, for evidence of authorization. For example, the use of text-recognition programs to examine large populations of documents, such as contracts, to identify items for further audit consideration.
Observation	Observation consists of looking at a process or procedure being performed by others. Observation provides audit evidence about the performance of a process or procedure but is limited to the point in time at which the observation takes place and by the fact that the act of being observed may affect how the process or procedure is performed.	Observation of an entity's physical inventory count. Remote observation tools (e.g. a camera mounted on a drone or a video transmission) may aid in performing an inspection or an observation procedure, such as management's physical inventory count.
Inquiry	Inquiry consists of seeking information from knowledgeable persons in financial or nonfinancial roles within or outside the entity. Inquiries may range from formal written inquiries to informal oral inquiries.	Inquiries with management regarding related party relationships and transactions
External confirmation	An external confirmation represents audit evidence obtained as a direct written response to us from a third party (the confirming party) on paper or by electronic or other medium - e.g. through our direct access to information held by a third party.	Confirmation of accounts receivable balances with customers.

Recalculation	Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically. By using automated tools and techniques, we may be able to perform recalculation procedures on 100% of a population.	Recalculating fees in accordance with contractual terms. Recalculating the gross margin for each product sold for an entity's product line.
Reperformance	Reperformance involves our independent execution of procedures or controls that were originally performed as part of the entity's internal control and entails using the same information as the control operator/IT system and seeing if we came to the same result. We separately consider the reliability of the information used in the control and cannot infer the performance of the control by comparison to independent information.	Reperformance of a bank reconciliation.
Analytical procedures	Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations or relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.	Substantive analytical procedures over interest expense based on expected relationships with debt terms.

Do we perform tests of details, Substantive Analytical Procedures (SAPs) or both to respond to the level of CAR? [ISA | 1289.1700]

To respond to the level of CAR, we may perform tests of details, SAPs or a combination of both. Performing more than one procedure may increase the persuasiveness of evidence we obtain, as long as each procedure is responsive to the RMM and provides sufficient appropriate audit evidence on its own.

There are benefits to combining a SAP and test of details, including:

- having the big picture that the SAP provides, while still obtaining evidence from examining individual transactions;
- having the ability to potentially reduce the extent of our test of details because we are also obtaining audit evidence from a SAP performed to address the same RMM. This is also helpful

when performing audit procedures to address risks related to accounts with large balances and where audit sampling may result in large sample sizes.

1.2.1.2 Design and perform substantive procedures whose timing is responsive to CAR [ISA | 1290]

What do we do?

Design and perform substantive procedures whose timing is based on and responsive to the combined assessed risk of the risk of material misstatement

Why do we do this?

Performing audit procedures at different points throughout the audit (i.e. interim or period-end) can alter the evidence we obtain.

We appropriately plan the timing of our audit procedures so that we perform procedures to obtain sufficient appropriate audit evidence to respond to risks of material misstatement (RMMs).

Execute the Audit

What are the approaches to the timing of substantive procedures? [ISA | 1290.10829]

The three different approaches to the timing of substantive procedures are:

Approach	Description
Approach 1 Perform procedure at an interim date and roll forward	We perform our substantive audit procedures at an interim date and perform procedures to extend our audit conclusions to period-end ('rollforward procedures').
Approach 2 Perform the procedure throughout the period	We perform part of our procedures at an interim date, then perform remaining substantive audit procedures at period-end. The substantive procedure is therefore not complete until the period-end, when we have obtained sufficient appropriate audit evidence. For example, we are testing certain revenue transactions related to an RMM using audit sampling for a calendar year end entity. To perform procedures on the population using approach 2 we:

	• sample and perform substantive procedures over items using the actual population through September 30; • sample and perform the same substantive procedures over items using the actual population from the period October 1 through December 31; and • Combine the two samples during evaluation to conclude on the full year of activity as we have tested cumulative items. Although we performed some of our procedures at an interim date (September 30), we have not tested a sufficient number of items until we complete our testing through the period-end.
Approach 3 Perform the procedure at period-end only	We perform substantive procedures at period-end (i.e., during final fieldwork) to obtain sufficient appropriate audit evidence instead of performing the procedures at several points of time throughout the period. For example, we determine the appropriate sample size based on the period-end account balance or the activity for the entire period and perform the procedures during final fieldwork.

What are the benefits and risks of each approach to the timing of substantive audit procedures? [ISA | 1290.10830]

The following table describes the benefits and risks of each approach to the timing of substantive audit procedures:

Approach	Benefits	Risks
Approach 1	**Early identification of issues** Identifying issues early gives management and us time to respond to those issues earlier in the audit. **Reduce last-minute decisions** This approach reduces the likelihood of making all or too many of our critical decisions and judgments too close to period-end. **Resources** We have a finite amount of resources and time between period-end and issuing our report, so it may not	**Material misstatement in the remaining period** The earlier the interim date, the greater this risk becomes. **New information contradicting initial risk assessments or introducing new risks** We may obtain new information that introduces a new risk, or contradicts the information on which we based our initial risk assessments or is not addressed by the procedure we already performed.

	be practical to perform all of our audit procedures at period-end. This approach spreads the work over a longer period.	For example, we may have based our sample sizes on a CAR assessment of Base Controls Reliance 'BC'. If we subsequently increase inherent risk (and therefore CAR changes), then we have not tested enough items and we have additional procedures to perform. **Increase in detection risk** There is an increased risk that we may not detect material misstatements that may exist at the period end. This risk increases as the length of the rollforward period increases.
Approach 2	**Early identification of issues** **Does not increase detection risk** We don't increase detection risk because our procedures address the entire audit period.	**New information contradicting initial risk assessments or introducing new risks**
Approach 3	**Avoid inefficiencies** This approach is useful when we are addressing an RMM that relates to the period-end. For example, when performing procedures over a recurring fair value measurement (e.g. trading securities), the procedures we perform at an interim date may not provide evidence over the valuation at period-end and therefore may be repeated. We have access to a complete population of the underlying transactions to perform our testing.	**Resources** Performing procedures at period-end may result in time pressure on the entity and engagement team. **Late identification of issues** If we identify additional RMMs that we had not identified at planning, we have less time to respond.

	Does not increase detection risk	

How do we design and perform substantive procedures whose timing is responsive to the combined assessed risk (CAR) of the RMM? [ISA | 1290.1400]

To design and perform substantive procedures whose timing is responsive to the CAR of the RMM, we perform the following activities:

- Determine the approach to the timing of substantive procedures;
- If we use approach 1 then perform relevant procedures.

Do we perform all our substantive procedures using the same approach to timing? [ISA | 1290.1600]

No. We tailor our substantive procedures to obtain sufficient appropriate audit evidence to respond to CAR of the RMM. Not all substantive procedures are performed at the same time in the same way, and it may not be appropriate to design and perform our procedures using the same approach.

We also think about performing procedures on an unannounced basis or at an unpredictable time when determining the timing of our substantive procedures.

Examples

What substantive procedures may we perform using approach 1? [ISA | 1290.2500]

Test of Details

Fact pattern

During planning and risk assessment, the engagement team identify the following RMMs related to overstatement or understatement of revenue:

- revenue transactions may be recorded using incorrect prices; and
- revenue transactions may be recorded using incorrect quantities.

For both RMMs, CAR is assessed as Base Controls Reliance ('BC').

To respond to these RMMs, the team plans to perform the following substantive procedure for revenue.

- Select a sample of sales invoices;
- Vouch the invoice to shipping documents; and
- Agree total invoice amount to the cash receipt.

Analysis

Interim procedures:

The engagement team select and perform the substantive procedure over a sample of invoices from the period January 1 to October 31. After performing the procedures, the team evaluate the results as of October 31.

Rollforward procedures:

After comparing the interim and period-end information, they identify and investigate unusual items over which they perform separate substantive audit procedures. After thinking about the

specific RMM(s) and changes (or lack thereof) in the rollforward period, the team determine to use a substantive analytical procedure (SAP) that predicts revenue for the roll forward period.

At both interim and period-end, the engagement team uses SPM when developing their procedures.

Substantive Analytical Procedures

Fact pattern

During planning and risk assessment, the engagement team identify the following RMMs related to overstatement or understatement of revenue:

- revenue transactions may be recorded using incorrect prices; and
- revenue transactions may be recorded using incorrect quantities.

For both RMMs CAR is assessed as Base Controls Reliance ('BC').

Analysis

Interim procedures:

The team design and perform a SAP that develops an expectation of the amount of revenue recorded from January 1 to October 31. After performing the procedures, they evaluate the results as of October 31.

Rollforward procedures:

After comparing the interim and period-end information, they identify and investigate unusual items over which they perform separate substantive audit procedures. Then they select a sample of invoices, vouch the invoice to shipping documents and agree total invoice amount to the cash receipt

At both interim and period-end, the engagement team uses SPM when developing their procedures.

What substantive procedures may we perform using approach 2? [ISA | 1290.2700]

Test of Details

Fact pattern

During planning and risk assessment, the engagement team identify the following RMMs related to overstatement or understatement of revenue:

- revenue transactions may be recorded using incorrect prices; and
- revenue transactions may be recorded using incorrect quantities.

For both RMMs CAR is assessed as Base Controls Reliance ('BC').

Analysis

Interim procedures:

To perform the procedures throughout the period, the engagement team use audit sampling using full performance materiality to select sales invoices recorded from January 1 to October 31 and perform their procedures. The team do not reach a conclusion as at the interim date.

Period-end procedures:

The team use audit sampling using full performance materiality to select sales invoices recorded from November 1 to December 31. They evaluate the results of their procedures for the entire period (including both interim and final) to reach a conclusion at period end.

What substantive procedures may we perform using approach 3? [ISA | 1290.10843]

Test of Details

Fact pattern

During planning and risk assessment, the engagement team identify the following RMMs related to overstatement or understatement of revenue:

- revenue transactions may be recorded using incorrect prices; and
- revenue transactions may be recorded using incorrect quantities.

For both RMMs CAR is assessed as Base Controls Reliance ('BC').

Analysis

There are no substantive procedures performed at interim. The team use audit sampling to select sales invoices recorded from January 1 to December 31, and evaluate the results of their procedures for the entire period at period-end.

1.2.1.3 Design and perform substantive procedures whose extent is responsive to CAR [ISA | 1296]

What do we do?

Design and perform substantive procedures whose extent is based on and responsive to the combined assessed risk of the risk of material misstatement.

Why do we do this?

The more extensively a procedure is performed, the more audit evidence we obtain from that procedure.

We design and perform our procedures taking into consideration the extent to obtain sufficient appropriate audit evidence to address the combined risk assessment (CAR) of the risk of material misstatement (RMM).

Execute the Audit

How do we design and perform substantive procedures whose extent is based on and responsive to the CAR of the RMM? [ISA | 1296.1500]

The following table describes the factors we think about when we design and perform substantive procedures whose extent is based on and responsive to the CAR of the RMM:

Factor	What we think about
Nature of the procedure	When performing tests of details, we increase the extent of our procedures by increasing the number of items we test or the proportion of the population we examine.

	When we test all items/the entire population, we obtain the most persuasive evidence. When performing a substantive analytical procedure (SAP, it may be applied to an entire account balance or set of transactions and not individual items. We alter the extent of an SAP by how we design the procedure, which impacts its level of precision. For example, we may be able to develop more precise expectations and increase the persuasiveness of our SAP - e.g. through more disaggregation.
Materiality	The extent of evidence we obtain may be greater when the account balance is greater. The higher the balance is above performance materiality (or specific performance materiality if applicable), the greater the extent of evidence we obtain.
The degree of assurance from the procedure	In some cases, we may not be deriving all of our audit evidence from one procedure. For example, we may plan two or more procedures to address the same RMM, such as performing an SAP along with tests of details. When both procedures address the same RMM, we may be able to alter the extent of testing for one of them because the degree of assurance sought from the procedure may be less. This applies when we are using tests of details for one of the procedures.

1.2.1.4 Define the population and items to be tested, including misstatements/errors [ISA | 7606]

What do we do?

IF we are performing a test of details THEN define the population, including relevant characteristics, determine that it is complete AND define items to be tested, including what constitutes a misstatement/ error

Why do we do this?

Defining the population and items to be tested helps us determine that the procedure is appropriately designed to address the identified risk of material misstatement (RMM). Our substantive procedures are only effective when the population from which we select items for testing is complete.

Defining what constitutes a misstatement/error before we select items helps us appropriately identify misstatements/errors when performing our testing.

Our definition of a misstatement/error affects how we evaluate the results of our audit procedures. Therefore, the more clearly we define what represents a misstatement/error upfront, the better we can evaluate the audit evidence obtained and our conclusion.

Execute the Audit

What is the population to be tested for a test of details? [ISA | 7606.12852]

The population to be tested for a test of details is the complete set of items to be tested from which we select and perform our procedures over.

How do we define the population to be tested for a test of details? [ISA | 7606.12853]

When we are auditing a RMM that relates to an entire account balance or 100% of the activity within an account, defining the population is simple - the population is all of the individual transactions within the account that were recorded throughout the period or individual balances in the account as of period end.

When we are trying to address an RMM that does not relate to an entire account balance (e.g., a specific transaction type or potential unrecorded items), we think about the nature of the RMM in order to define the population, or perform an initial specific item test to determine the characteristics of a population.

> For example, we have identified an RMM for revenue: For performance obligations satisfied at a point in time, revenue is not recognized when control is transferred to the customer, resulting in revenue not being recognized in the correct accounting period for shipments made near period end. The entity primarily uses recognition terms of FOB Destination.
>
> We plan to perform a test of details to select a sample of shipments with terms of FOB Destination to test that transactions during period end were recognized in the correct period.
>
> In order to define the population, we determine the duration of time around period end where the RMM exists. Then we obtain a complete listing of shipments and filter out any transactions that do not include FOB Destination terms prior to our sampling of that population.

What relevant characteristics may we think about in defining the population in a substantive test of details? [ISA | 7606.12855]

The following table describes the factors we think about when defining the population for test of details:

Characteristic	What do we think about?
Sub-populations	If there are groups within our population that have different RMMs, different levels of CAR and/or the nature of controls is different, we think about separating the population into sub-populations. For example, if there are separate processes for processing and recording domestic sales and international sales, we may determine that designing procedures over each population is appropriate.
Positive and negative items	It may not be appropriate to test a combined population with both positive and negative items. To achieve our testing

	objective, we may: • review the population to determine if there are offsetting transactions or to determine if there is a sub-population to be split out (e.g. different types of transactions); • ask management to remove offsetting items or split the population, as appropriate; • if there are different types of transactions, test those populations	

	separately/ treat as subpopulations (and consider if they are representative of a different RMM).
Multiple locations	If we have a population spread across locations, we think about whether the locations represent a single population or multiple sub-populations to be tested separately (see question 'How do we determine whether to treat multiple locations as a population?').

Zero value items	Zero value items cause us to question if we have the correct population and we investigate and consider the appropriateness and the reason for such 0 value items.
Types of transactions in the population	If the population contains single transactions/ income statement items, we may be able to test at different times in the period under audit. This may not be possible for balance sheet items. For example, when testing the cash balances, testing in an interim period may not provide evidence for the period end balance.

How do we determine that the population to be tested for a test of details is complete? [ISA | 7606.12856]

Determining the completeness of the population may be possible by comparing the total of the population to the general ledger account we are testing. However, when this cannot be performed we may design other procedures to determine the completeness of the population.

> For example, obtaining a population that agrees to the general ledger and then filtering that population for the characteristics of the population we want to test (e.g. all transactions greater than a certain threshold).

If we are using a reciprocal population during our procedure, we determine that the reciprocal population is appropriate to test completeness of the target population and is a complete population as well.

What is a reciprocal population? [ISA | 7606.11781]

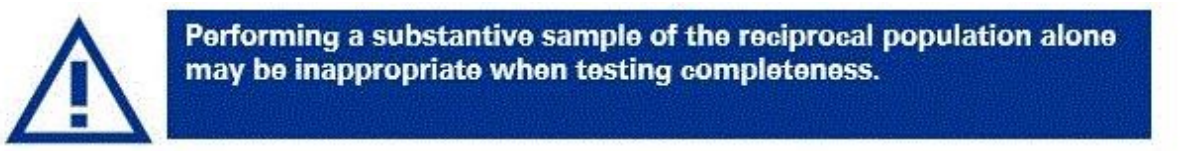
A reciprocal population is a population of items that are related to the account we are testing. Reciprocal populations contain items that should be included in the account that we are testing; however, they may also include other items. A reciprocal population can be valid even when it includes additional items not relevant to the balance being tested. Reciprocal populations are most often used when we test for understatement.

> For example, if we are performing a search for unrecorded liabilities to determine if the liability balance is understated, a reciprocal population may be all cash disbursements subsequent to the balance sheet date. This reciprocal population will include payments for items that were outstanding at year-end, as well as cash payments relating to the subsequent period. We may test these cash payments to obtain evidence that these subsequent payments are correctly not included in the balance being tested.
>
> If we are testing cut-off of revenue, the reciprocal population may be post-period end sales invoices.

How do we determine the appropriate reciprocal population? [ISA | 7606.11782]

To determine the appropriate reciprocal population, we think about facts and circumstances of the entity, and if there are types of transactions that we could test to obtain evidence about transactions that may not be recorded by the entity. As with any population to be sampled, we determine that it is complete (see question 'How do we determine that the population to be tested for a test of details is complete? ') before we select and test items.

> For example, if our objective is to test the completeness of accounts payable at year-end, examining subsequent disbursements and items recorded into accounts payable after period-end may provide evidence about accounts payable transactions not recorded by the entity. These are therefore appropriate reciprocal populations.
>
> If accounts payable turnover is 90 days, in other words, items are paid on average 90 days after being received and recorded by the entity; sampling from 60 days of post year-end cash disbursements may not provide sufficient evidence over the completeness of the year-end AP balance on its own.



We think about performing additional procedures when testing completeness, such as an entity's inventory tag control for an inventory count or trend analysis of payments by vendor for the search for unrecorded liabilities.

How do we define misstatements in a reciprocal population? [ISA | 7606.11783]

When we test items that are in the reciprocal population, a misstatement arises if that item is incorrectly omitted in the account we are testing, or is recorded at an incorrect value in the period under audit.

When we test a reciprocal population, we may select items that do not relate to the account we are testing. When we test such items, we confirm that they are not included in account we are testing.

How do we define the items to be tested for a test of details? [ISA | 7606.12858]

To define the items to be tested for a test of details we think about:

- how the population can be broken-down;
- the RMM that the procedure is designed to address;
- our test objective and planned audit procedures; and
- how we can effectively and efficiency to achieve our test objective, including planned alternative procedures.

> For example, if the planned audit procedure is external confirmation of accounts receivable, we think about at what level to include transactions on the confirmation (e.g. total outstanding balance by customer, by invoice, or by individual line item within the invoice) and which level provides sufficient appropriate audit evidence to address the RMM.
>
> Once we have defined the item, we obtain a listing of the population by item. We perform audit procedures over the entire balance of each item selected to avoid not obtaining sufficient audit evidence. For example, if we perform alternative procedures over a confirmation of a customer's account balance that contained 20 invoices, we perform our procedures over all 20 invoices, since the customer balance was the item we defined.

What is a misstatement? [ISA | 7606.1300]

A misstatement, if material individually or in combination with other misstatements, causes the financial statements not to be presented fairly in conformity with the applicable financial reporting framework.

A misstatement may relate to a difference between the reported amount, classification, presentation or disclosure of a financial statement item and the amount, classification, presentation or disclosure that should be reported in conformity with the applicable financial reporting framework.

What is an error? [ISA | 7606.1400]

When performing an attribute sample, an error is either incorrect classification or omission.

How do we define a misstatement for a test of details? [ISA | 7606.12861]

When defining what constitutes a misstatement for a substantive test of details we consider:

- the RMM(s) and relevant assertion that the procedure is designed to address;
- relevant factors obtained from our understanding of the business and flow of transactions;
- the purpose of the audit procedure; and
- the items we are selecting for testing.

> For example, if we are confirming accounts receivable balances at year-end, differences raised due to payments made by the customer before the confirmation date but received shortly after that date by the entity are not considered a misstatement.
>
> Also, a misposting between customer accounts may not affect the total accounts receivable balance. Therefore, it may not be appropriate to consider this type of difference a misstatement in evaluating the results of this particular audit procedure. However, the misposting may have an impact on other areas of the audit, such as the adequacy of the allowance for doubtful accounts or conclusions about the effectiveness of the entity's controls over recording revenue transactions and customer payments.

Example

How do we define a misstatement? [ISA | 7606.12864]

Fact pattern

An engagement team designs procedures to send external accounts receivable confirmations to a selection of customers within the population. The team defines the population as the individual invoices for customers outstanding or unpaid at year-end, which total to the gross accounts receivable balance at year-end (i.e. not considering any credit memos issued or adjustments).

Analysis

The engagement team does not consider an exception noted on the confirmation for credit notes issued for a valid return after year-end as a misstatement. Instead, they define a misstatement as 'when the amount recorded by the entity does not agree to the gross invoice amount outstanding in the confirmation response'.

The definition of a misstatement focuses on the defined population (gross accounts receivable balance) and the test objective (Existence of gross accounts receivable).

1.2.2 Perform minimum expected substantive procedures for identified RMMs [ISA | 7940]

What do we do?

Perform minimum expected substantive procedures (MESPs), where they are available, for those risks of misstatements (RMs) that we have identified as risks of material misstatement (RMMs).

Why do we do this?

We perform MESPs to drive consistency in our response to certain RMMs and our documentation of that response.

Execute the audit

What are MESPs? [ISA | 7940.9776]

MESPs are the 'minimum' substantive procedures to respond to certain RMMs. There are three types of MESPs that we perform:

- MESPs that respond to identified assertion-level RMMs;
- MESPs necessary to support the response to RMM(s) in the accounting processes but which are not directly associated with specific RMMs; and
- MESPs related to estimate(s).

When do we perform each type of MESP? [ISA | 7940.9777]

We perform each type of MESP as follows:

Type of MESP	Circumstance
MESPs that respond to identified assertion-level RMMs	We perform the MESP if: • we have assessed the RM associated with the MESP as an RMM; and • any applicable conditions (account scaling, transactions, events and conditions (TECs) and response scaling) are met.
MESPs necessary to support the response to RMM(s) in the accounting processes but which are not directly associated with specific RMMs	We perform these MESPs when we have at least one RMM in an accounting process for which these MESPs have been developed. Examples of MESPs necessary to support the response to RMMs include sub-ledger to general ledger reconciliations, and roll-forwards of opening balances at the beginning of the period to closing balances as at the period end. They are usually performed in association with other substantive procedures and form part of the audit evidence over one or more RMM(s) for various accounts/ processes.
MESPs related to estimate(s)	We perform applicable MESPs for an estimate when we have assessed the risk associated with the selection of the methods, assumptions, or data as RMMs and/or application of the methods, assumptions, and data as RMMs.

Will performing the MESP(s) associated with an RMM provide us with sufficient appropriate audit evidence over that RMM? [ISA | 7940.9778]

It depends. MESPs may not be sufficient on their own to respond to an RMM.

We apply professional judgment to evaluate whether the response provided by the MESP(s) sufficiently addresses the risks within the RMM based on the specific facts and circumstances of the entity and perform additional audit procedures beyond the MESP(s) when necessary.

How does the CAR assessment for an RMM impact MESPs? [ISA | 7940.9779]

MESPs do not contemplate the CAR assessment for a particular RMM.

As a result, it may be necessary to perform additional procedures, or to alter the timing and/or extent of procedures as the inherent risk increases - i.e. elevated or significant or where a fraud risk is identified, or depending on our controls reliance decision.

How do we identify MESPs? [ISA | 7940.9780]

In KPMG Clara workflow, MESPs are identified in the substantive procedure library by the globe icon:  .

For some MESPs, in addition to the RM selection, the display of this icon in the library is driven by selections we have made upstream - specifically the accounts, TECs and any response scaling options we selected.

In some cases, a choice of MESPs will be given in response to a particular RMM - for example, either a test of detail or a substantive analytical procedure, which we determine based on the specific facts and circumstances of the current year audit.

How do we identify those RMs and estimates with which MESPs are associated? [ISA | 7940.9781]

The globe

icon is displayed alongside those RMs and estimates (i.e., estimate names and elements) that have one or more MESPs associated with them.

The absence of the

icon does not indicate that an RM or estimate is not applicable, or that it may not be assessed as an RMM. Such determination continues to be based on our risk assessment specific to the circumstances of the current year audit.

Which processes include MESPs? [ISA | 7940.9782]

A full list of processes for which MESPs have been developed are available on Alex.

Are there circumstances where a MESP could be considered not necessary or not applicable? [ISA | 7940.9783]

In rare circumstances, we may determine that the MESP is not necessary to obtain sufficient appropriate audit evidence or is not applicable.

In these circumstances, we rebut the MESP and document the rationale for the rebuttal, which the engagement partner reviews.

When our member firm has rebutted an IFRS or US GAAP MESP, we apply any requirements and/or guidance they issue.

Can we modify an MESP? [ISA | 7940.9786]

We can modify an MESP if we determine that it is necessary for the specific facts and circumstances of the current year audit.

In this case, we do not directly modify the standard procedure. Rather, we 'clarify' the procedure and document how and why the procedure (or particular steps within the procedure) will be performed differently for the current year audit. This includes the rare circumstances when we determine that a particular step within a procedure is not applicable.

When our member firm has modified an IFRS or US GAAP MESP, we apply any requirements and/or guidance they issue.

What are the approaches to the timing of MESPs? [ISA | 7940.9850]

We perform MESP's in the same way as any other substantive procedures whose timing is responsive to CAR (see activity 'Design and perform substantive procedures whose timing is responsive to CAR').

The three different approaches to the timing of MESP are:

Approach	Description
Approach 1 Perform MESP at an interim date and roll forward	We perform MESPs at an interim date and perform other procedures to extend our audit conclusions to period-end ('rollforward procedures').
Approach 2 Perform the MESP throughout the period	We perform part of MESPs at an interim date, then perform rest of the same MESPs at period-end. The MESP is therefore not complete until the period-end, when we have obtained sufficient appropriate audit evidence.
Approach 3 Perform the MESP at period-end only	We perform MESPs at period-end (i.e., during final fieldwork) to obtain sufficient appropriate audit evidence instead of performing the procedures at several points of time throughout the period.

1.3 Take into account potential misstatements from an SUT [ISA | 592]

What do we do?

Take into account the types of potential misstatements that could result from a significant unusual transaction in designing and performing further audit procedures

Why do we do this?

Given the unique nature, size and complexity of significant unusual transactions (SUTs), they often present a risk of material misstatement (RMM) that is higher on the inherent risk continuum. This is because there may be:

- greater management intervention to specify the accounting treatment;
- greater manual intervention for data collection and processing;
- complex calculations or accounting principles;
- difficulty in implementing effective processes to account for the transactions (due to their non-routine nature); and/or
- related party transactions.

We take into account the types of potential misstatements that could result from SUTs, to appropriately identify the relevant RMMs and design and perform further audit procedures to respond to them.

Execute the Audit

What is a significant unusual transaction (SUT)? [ISA | 592.14472]

A SUT is a significant transaction that is outside the normal course of business for the entity or that otherwise appears to be unusual due to its timing, size, or nature.

What is a type of potential misstatement? [ISA | 592.1400]

'Types of potential misstatements' are the various ways an account or disclosure could be affected by a risk of misstatement. Thinking about the types of potential misstatement enables us to identify the risk at a granular level.

First, we think about how the risk could affect the financial statements broadly, by asking ourselves "what could go wrong" because of this risk. Then, once we understand this, we can think about how specific accounts, disclosures and assertions might be affected.

> For example, we may first determine that a risk affects how the entity records the inventory it buys and sells. This information might help us better identify potential misstatements and their possible impact on inventory and cost of goods sold.

What types of potential misstatements could result from a SUT? [ISA | 592.1500]

The types of potential misstatements that could result from a SUT may include:

- a financial statement misstatement in the accounting over the SUT;

- a misstatement in the presentation of the SUT;
- misstated or omitted disclosure of the SUT.

How do we change our procedures for the types of potential misstatements that could result from a SUT? [ISA | 592.1600]

The fact that we consider types of potential misstatements for SUTs when designing and performing audit procedures is no different from any other transaction/balance/disclosure. We consider types of potential misstatements, their likelihood and magnitude, including the possibility that they can result in a risk of material misstatement (RMM).

However, because SUTs are by their nature unusual, there is an increased risk of error, as well as a possible fraud risk. As a result, we modify our nature, timing, and extent of procedures to reflect this increase in inherent risk in order to obtain sufficient appropriate audit evidence related to the relevant RMM. In addition, when we have determined that a significant risk exists, including a fraud risk, we also evaluate the design and implementation of the entity's controls addressing those risks.

Is the inherent risk of RMMs associated with SUTs always significant? [ISA | 592.1900]

No, not all the RMMs associated with a SUT will give rise to a significant risk. In many cases, however, we assess those risks as either significant or elevated.

Tests of Controls

International Standards on Auditing: ISA 330.08-11

Tests of Controls

8. The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of controls if:

(a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (that is, the auditor plans to test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or

(b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. (Ref: Para. A20-A24)

9. In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. (Ref: Para. A25)

Nature and Extent of Tests of Controls

10. In designing and performing tests of controls, the auditor shall:

(a) Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:

(i) How the controls were applied at relevant times during the period under audit;

(ii) The consistency with which they were applied; and

(iii) By whom or by what means they were applied. (Ref: Para. A26-A31)

(b) To the extent not already addressed, determine whether the controls to be tested depend upon other controls (indirect controls), and, if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls. (Ref: Para. A32)

Timing of Tests of Controls

11. The auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls, subject to paragraphs 12 and 15 below, in order to provide an appropriate basis for the auditor's intended reliance. (Ref: Para. A33)

ISA Application and Other Explanatory Material: ISA 330.A20-A33

Tests of Controls

Designing and Performing Tests of Controls (Ref: Para. 8)

A20. Tests of controls are performed only on those controls that the auditor has determined are suitably designed to prevent, or detect and correct, a material misstatement in a relevant assertion, and the auditor plans to test those controls. If substantially different controls were used at different times during the period under audit, each is considered separately.

A21. Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls. However, the same types of audit procedures are used. The auditor may, therefore, decide it is efficient to test the operating effectiveness of controls at the same time as evaluating their design and determining that they have been implemented.

A22. Further, although some risk assessment procedures may not have been specifically designed as tests of controls, they may nevertheless provide audit evidence about the operating effectiveness of the controls and, consequently, serve as tests of controls. For example, the auditor's risk assessment procedures may have included:

- Inquiring about management's use of budgets.
- Observing management's comparison of monthly budgeted and actual expenses.
- Inspecting reports pertaining to the investigation of variances between budgeted and actual amounts.

These audit procedures provide knowledge about the design of the entity's budgeting policies and whether they have been implemented, but may also provide audit evidence about the effectiveness of the operation of budgeting policies in preventing or detecting material misstatements in the classification of expenses.

A23. In addition, the auditor may design a test of controls to be performed concurrently with a test of details on the same transaction. Although the purpose of a test of controls is different from the purpose of a test of details, both may be accomplished concurrently by performing a test of controls and a test of details on the same transaction, also known as a dual-purpose test. For example, the auditor may design, and evaluate the results of, a test to examine an invoice to determine whether it has been approved and to provide substantive audit evidence of a transaction. A dual-purpose test is designed and evaluated by considering each purpose of the test separately.

A24. In some cases, the auditor may find it impossible to design effective substantive procedures that by themselves provide sufficient appropriate audit evidence at the assertion level.[3] This may occur when an entity conducts its business using IT and no documentation of transactions is produced or maintained, other than through the IT system. In such cases, paragraph 8(b) requires the auditor to perform tests of controls that address the risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence.

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3 ISA 315 (Revised 2019), paragraph 33

Audit Evidence and Intended Reliance (Ref: Para. 9)

A25. A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

Nature and Extent of Tests of Controls

Other audit procedures in combination with inquiry (Ref: Para. 10(a))

A26. Inquiry alone is not sufficient to test the operating effectiveness of controls. Accordingly, other audit procedures are performed in combination with inquiry. In this regard, inquiry combined with inspection or reperformance may provide more assurance than inquiry and observation, since an observation is pertinent only at the point in time at which it is made.

A27. The nature of the particular control influences the type of procedure required to obtain audit evidence about whether the control was operating effectively. For example, if operating effectiveness is evidenced by documentation, the auditor may decide to inspect it to obtain audit evidence about operating effectiveness. For other controls, however, documentation may not be available or relevant. For example, documentation of operation may not exist for some factors in the control environment, such as assignment of authority and responsibility, or for some types of controls, such as automated controls. In such circumstances, audit evidence about operating effectiveness may be obtained through inquiry in combination with other audit procedures such as observation or the use of CAATs.

Extent of tests of controls

A28. When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control. As well as the degree of reliance on controls, matters the auditor may consider in determining the extent of tests of controls include the following:

- The frequency of the performance of the control by the entity during the period.
- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
- The expected rate of deviation from a control.
- The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
- The extent to which audit evidence is obtained from tests of other controls related to the assertion.

ISA 530[4] contains further guidance on the extent of testing.

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4 ISA 530, *Audit Sampling*

A29. Because of the inherent consistency of IT processing, it may not be necessary to increase the extent of testing of an automated control. An automated control can be expected to function consistently unless the IT application (including the tables, files, or other permanent data used by the IT application) is changed. Once the auditor determines that an automated control is functioning as intended (which could be done at the time the control is initially implemented or at some other date), the auditor may consider performing tests to determine that the control continues to function effectively. Such tests may include testing the general IT controls related to the IT application.

A30. Similarly, the auditor may perform tests of controls that address risks of material misstatement related to the integrity of the entity's data, or the completeness and accuracy of the entity's system-generated reports, or to address risks of material misstatement for which substantive procedures alone cannot provide sufficient appropriate audit evidence. These tests of controls may include tests of general IT controls that address the matters in paragraph 10(a). When this is the case, the auditor may not need to perform any further testing to obtain audit evidence about the matters in paragraph 10(a).

A31. When the auditor determines that a general IT control is deficient, the auditor may consider the nature of the related risk(s) arising from the use of IT that were identified in accordance with ISA 315 (Revised 2019)[110] to provide the basis for the design of the auditor's additional procedures to address the assessed risk of material misstatement. Such procedures may address determining whether:

- The related risk(s) arising from IT has occurred. For example, if users have unauthorized access to an IT application (but cannot access or modify the system logs that track access), the auditor may inspect the system logs to obtain audit evidence that those users did not access the IT application during the period.
- There are any alternate or redundant general IT controls, or any other controls, that address the related risk(s) arising from the use of IT. If so, the auditor may identify such controls (if not already identified) and therefore evaluate their design, determine that they have been implemented and perform tests of their operating effectiveness. For example, if a general IT control related to user access is deficient, the entity may have an alternate control whereby IT management reviews end user access reports on a timely basis. Circumstances when an application control may address a risk arising from the use of IT may include when the information that may be affected by the general IT control deficiency can be reconciled to external sources (e.g., a bank statement) or internal sources not affected by the general IT control deficiency (e.g., a separate IT application or data source).

110 ISA 315 (Revised 2019), paragraph 26(c)(i)

Testing of indirect controls (Ref: Para. 10(b))

A32. In some circumstances, it may be necessary to obtain audit evidence supporting the effective operation of indirect controls (e.g., general IT controls). As explained in paragraphs A30 to A31, general IT controls may have been identified in accordance with ISA 315 (Revised 2019) because of their support of the operating effectiveness of automated controls or due to their support in maintaining the integrity of information used in the entity's financial reporting, including system-generated reports. The requirement in paragraph 10(b) acknowledges that the auditor may have already tested certain indirect controls to address the matters in paragraph 10(a).

Timing of Tests of Controls

Intended period of reliance (Ref: Para. 11)

A33. Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose, for example, when testing controls over the entity's physical inventory counting at the period end. If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of controls in the entity's process to monitor the system of internal controls.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Determine whether to take a controls approach, and design tests of control activities [ISA | 596]

What do we do?

Determine whether to take a controls approach in our audit of the financial statements, and design procedures to test control activities

Why do we do this?

To address risks of material misstatement (RMMs), we design and perform audit procedures to obtain persuasive — i.e. sufficient and appropriate — audit evidence.

Our planned audit procedures can consist of a substantive testing approach, which does not include tests of control activities, or a controls approach, which includes both tests of control activities and substantive tests.

Although we may not always take a controls approach in a financial statement audit, in some circumstances we may either choose or the auditing standards may tell us to test control activities.

Execute the Audit

What is a controls approach? [ISA | 596.1300]

If we intend to test and rely on controls to alter our substantive procedures, we obtain evidence that those control activities are operating effectively for the period over which we intend to rely on them. We call this a controls approach.

In a controls approach, we evaluate design and implementation, and test operating effectiveness so that we can rely on the control activities to alter our substantive procedures.

When we evaluate the design and implementation of control activities, are we taking a controls approach? [ISA | 596.1400]

No. A controls approach includes testing the operating effectiveness of relevant control activities. When we only evaluate the design and implementation of control activities related to a significant risk, we do not rely on those controls to alter our substantive procedures.

We evaluate the design and implementation of control activities associated with a significant risk; however, we do not test the operating effectiveness of these controls every time.

When do we take a controls approach? [ISA | 596.1500]

We test control activities when:

- substantive procedures alone provide insufficient appropriate audit evidence. See activity 'Test control activities when substantive procedures alone cannot provide sufficient audit evidence' for further information.
- it supports the accuracy and completeness of financial information we rely on to perform other audit procedures. See activity 'Test control activities to support the accuracy and completeness of financial information, when necessary' for further information.
- we plan to rely on controls to reduce our Combined Assessed Risk (CAR). See activity 'Test control activities to support Controls Reliance control risk assessment' for further information.
- we are performing an integrated audit.

We take a controls approach either because the auditing standards tells us to or because we believe it will be more effective or efficient. In those circumstances where we are deciding whether to take a controls approach or not, we weigh the benefit and cost of testing control activities to help us make the decision.

At what level do we take a controls approach? [ISA | 596.1600]

We take a controls approach at the individual RMM level, consistent with how we assess combined assessed risk (CAR).

What steps do we take when we decide to take a controls approach? [ISA | 596.1700]

When we decide to take a controls approach, we perform the following at the individual RMM level:

- identify process risk points
- determine which process control activities are relevant to the audit
- evaluate the design and implementation of process control activities
- test the operating effectiveness of controls.

Often, control activities rely on the effective design and operation of other controls - e.g. automated control activities rely on GITCs for consistent operation or other control activities may rely on information. In these cases, we also test the indirect controls, because they address all applicable process risk points related to the RMM or address relevant RAFITS.

What are the benefits of taking a controls approach? [ISA | 596.1900]

Depending on the evidence provided by testing control activities for a given RMM, we may be able to alter the nature, timing, and/or extent of our substantive tests and reduce the overall audit effort necessary.

We may also consider whether testing control activities offers any additional benefits — for example:

- the ability to provide better feedback to management and the audit committee on the entity's processes and internal controls;

- time savings in future audits by documenting and performing control tests in the current period — especially when we can use benchmarking to test automated process control activities in future periods; and
- better information to use in our risk assessments.

What are the costs of taking a controls based approach? [ISA | 596.2000]

The costs of taking a controls based approach come primarily from the incremental time and effort associated with evaluating the design, implementation and testing operating effectiveness of the controls. These will differ for each RMM.

Several factors may affect the effort to test controls, including their number and nature, the complexity of the test and how much evidence we have already obtained through other procedures — e.g. obtaining an understanding of internal control over financial reporting (ICFR) during risk assessment. We also consider whether management's controls are distinct from the process, and whether management retain sufficient documentation to evidence the design and operating effectiveness of controls.

In some cases, the nature of the RMMs may mean that testing and relying on controls doesn't significantly alter our substantive procedures. In those situations, we may decide to perform only substantive procedures, because testing controls may have little or no benefit.

In other cases, it may take minimal effort to obtain the evidence we use to rely on controls. For example, if we've already performed walkthroughs to understand the business process, identify applicable process risk points, and evaluate the design and implementation of controls, then the additional effort to test the operating effectiveness may be minimal.

Can we test the operating effectiveness of a control activity as we evaluate its design and implementation? [ISA | 596.10969]

Yes, but it may not be always appropriate because we test the operating effectiveness of the control activities throughout the period of reliance.

Testing the operating effectiveness of controls and evaluating their design and implementation at the same time is more appropriate for

- manual controls that operate infrequently throughout the year - e.g. annual and quarterly controls - and
- automated controls with effective general IT controls.

Although we may test the operating effectiveness of a control as we perform our procedures to evaluate its design and implementation, our procedures are designed to achieve both objectives.

Can we perform a dual-purpose test - e.g. a substantive test and a test of a process control activity concurrently? [ISA | 596.1800]

Yes. In some cases, we may choose to perform a dual-purpose test- e.g. a substantive test and a test of a process control activity concurrently. In doing so, we are careful not to assume the effective operation of controls based on the results of substantive procedures. Instead, we design dual-purpose tests to obtain evidence that accomplish the objectives of both tests at the same time, by obtaining independent evidence that the underlying transaction or balance is reasonably stated, and that management's control over the same transaction operated as it was designed.

Examples

When might an engagement team take a controls approach (based on cost/benefit considerations)? [ISA | 596.2200]

Fact pattern:

In developing the audit plan for Entity A, the engagement team are deciding whether to test and rely on control activities to alter their substantive procedures over RMMs that fixed asset depreciation may not be:

- accurately recorded;
- based on appropriate useful lives; or
- completely recorded for all depreciable fixed assets.

The team determines that there are no factors requiring them to evaluate the design and implementation of control activities or circumstances where substantive procedures alone provide insufficient appropriate audit evidence.

The team concludes that they can obtain equally persuasive audit evidence whether they perform substantive procedures only or take a controls approach. To decide whether to rely on controls, they consider the cost and benefits of testing those controls, as follows.

	Approach	
	Perform substantive procedures only	Controls approach
Time to test controls	-	40
Time to perform substantive procedures	80	20

Analysis:

Based on their estimate of the time to perform these audit procedures with or without relying on control activities to reduce substantive procedures, the engagement team expect a controls approach to which involves less overall time and effort than a substantive approach.

As such, the team choose to take a controls approach for the RMMs related to depreciation expense.

1.1 Test control activities to support Controls Reliance control risk assessment [ISA | 599]

What do we do?

IF we plan to assess control risk at Controls Reliance, THEN design and perform tests of relevant controls over those assessed risks of material misstatement.

Why do we do this?

To assess control risk for a risk of material misstatement (RMM) at Controls Reliance, we:

- take a controls based approach; and
- obtain evidence that the relevant controls are properly designed and operating effectively over the period of reliance.

Execute the Audit

What do Controls Reliance and No Controls Reliance mean? [ISA | 599.1300]

The terms 'Controls Reliance' and 'No Controls Reliance' describe our assessment of control risk.

Controls Reliance means we have sufficient evidence of the operating effectiveness of the related controls over each applicable process risk point related to an RMM over the entire period of reliance.

No Controls Reliance means we do not have evidence that the related controls are operating effectively for the entire period of reliance. This may be because:

- controls were missing, not properly designed and implemented, or not operating effectively; or
- we simply did not choose to test the operating effectiveness of the entity's controls.

At what level do we test and rely on control activities? [ISA | 599.157234]

We test and rely on control activities at the individual RMM level to alter our substantive procedures — i.e. at the same level as our CAR assessment.

If we intend to rely on controls for a particular RMM, we identify and test:

- process control activities that address all applicable process risk point(s) related to that RMM; and
- GITCs that support the effective operation of the identified automated control activities. However, if circumstances are appropriate, instead of testing GITCs, we may test the operating effectiveness of an automated process control activity at multiple points throughout the period.

We assess control risk at Controls Reliance for that RMM only when all applicable process risk points for an RMM are addressed by effective control activities.

What are 'indirect controls'? [ISA | 599.1500]

Indirect controls are those controls that may not directly respond to a process risk point related to the RMM but are necessary for the direct controls to operate effectively.

Examples of indirect controls include:

- CERAMIC controls
- Controls that support automated process control activities (GITCs)
- Controls that operate over the completeness and accuracy of information used in a control activity.

For example:

- When we test the effectiveness of a user review of exception reports detailing sales in excess of authorized credit limits, the user review and related follow up is the control that is

directly of relevance to us. Controls over the accuracy of the information in the reports (for example, the general IT controls) are the indirect controls.
- When we test the operating effectiveness of an automated process control activity, that control activity is a direct control. The related general IT controls are the indirect controls.

Do we test indirect controls? [ISA | 599.10971]

This will depend on the nature of the indirect controls and whether the evidence of the operation of the direct control activity is dependent on the operation of the indirect control.

When we test automated process control activities that rely on GITCs, we may test the GITCs. However, in certain circumstances, we may not test the operating effectiveness of the indirect controls, but rather test the operating effectiveness of the direct process control activities at multiple points in the period - see "Test automated process control activities throughout the period, if appropriate" [7612]

When determining the reliability of internal information used in a control that we test, we may not test the indirect controls over the accuracy and completeness of the information but rather adopt a direct testing approach - see "How do we determine which approach to take to test the accuracy and completeness of the internal information?" [2695 | 11582].

Do we test control activities related to all RMMs related to a particular account in the financial statement audit? [ISA | 599.1800]

Not necessarily. In the financial statement audit, we can plan to rely on and test control activities directly and indirectly related to one RMM but not necessarily for any others — even if the RMMs all relate to one account. For those RMMs where we don't take a controls based approach, we assess control risk at No Controls Reliance.

Do we test all process control activities that address the process risk point(s) related to an RMM? [ISA | 599.1700]

Not necessarily.

We only test enough process control activities to address each applicable process risk point at the right level of precision for that RMM.

Entities might design their internal control over financial reporting (ICFR) with intentional redundancies. This helps to protect against the possibility that one control may fail and result in a potential material misstatement occurring in the financial statements. However, we do not usually test duplicative process control activities that address the same process risk point.

For instance, an entity may put one control in place to *prevent* a possible source of misstatement, and another control to *detect and correct* the same source of misstatement. Both the preventative and detective controls may address the same process risk point(s). We may decide to test only the preventive control and not the detective control.

Examples

What if more than one control addresses an individual process risk point? [ISA | 599.2300]

Fact pattern:

The engagement team plan to assess control risk at Controls Reliance for a particular RMM, so they take a controls based approach.

As part of the process, data is transferred between a separate general ledger IT system of a subsidiary location and the entity's IT system. The entity uses the data to consolidate its subsidiary's general ledger. The team identify a process risk point related to inaccurate or incomplete data transferred between IT systems.

Management have two controls that address this process risk point.

The first control is an automated information processing control over the data transfer to validate that the data:

- transfers appropriately and completely from the subsidiary's general ledger IT system; and
- is accurately mapped in the consolidation IT system.

The second control is a monthly manual reconciliation control, which takes place after the data transfer. An individual manually compares the financial information in the subsidiary's general ledger to that in the consolidation IT system.

Analysis:

The information processing control (a preventative control) and the reconciliation control (a detective control) both sufficiently address the same process risk point relating to the risk of inaccurate or incomplete data transfer between IT systems. So the engagement team decide to test the information processing control and not the reconciliation control. This is because the information processing control alone sufficiently addresses the process risk point.

1.2 Test control activities when substantive procedures alone cannot provide sufficient audit evidence [ISA | 597]

What do we do?

IF substantive procedures alone cannot provide sufficient appropriate audit evidence, THEN test the operating effectiveness of control activities over those assessed risks of material misstatement

Why do we do this?

We test the operating effectiveness of controls over a risk of material misstatement (RMM) when we can't design substantive procedures capable of obtaining sufficient appropriate audit evidence on their own.

Execute the Audit

When may we be unable to obtain sufficient appropriate audit evidence from substantive procedures alone? [ISA | 597.1300]

We may not be able to obtain sufficient appropriate audit evidence from substantive procedures alone when a significant amount of information or data elements are electronically initiated, recorded, processed or reported. In this case, our ability to obtain sufficient appropriate audit evidence may depend on the entity's controls.

However, it is not necessary to test controls for every process with automated control activities or evidence in electronic form, except when the sufficiency and appropriateness of the substantive audit evidence depends on the entity's controls.

What are examples of when substantive procedures alone may not provide sufficient appropriate audit evidence? [ISA | 597.1400]

The following table sets out examples of situations in which performing substantive procedures alone may not provide sufficient appropriate audit evidence.

Scenario	Examples
The entity's financial reporting and accounting information systems rely heavily on IT, with little or no manual intervention. The entity also relies on embedded, automated process control activities to prevent or detect and correct misstatements that may occur during the activities to initiate, process and record financial transactions, and to create its financial statements.	• Customer orders are placed directly on the entity's system via the web, without a customer purchase order, contract or data file. • Customer agreements are signed online and maintained electronically in the entity's systems. • Approvals or document matching are performed online by the IT system with little or no manual intervention. • The entity runs an internet-based consumer marketplace that aggregates data about consumers and bills suppliers on a per click basis. It relies heavily on IT to deliver products and bill customers. • We have identified financial statement-level RMMs or significant risks arising from the use of IT.
Important information may exist solely in electronic form. The entity uses an IT system to provide summarized information from many different IT systems to business process owners or management, and management rely on database information and/ or system-generated reports to generate the financial statements.	• Each day, a retail entity's IT systems gather store sales data from multiple IT systems. Only automated process control activities exist to ensure management receives complete store sales data and aggregated sales data by region. There is no manual intervention, and there are no manual controls. Data transferred between IT systems does not include individual transactions to allow management (or us) to trace back to the source transactions. • We seek to use the history of price markdowns to audit a retail entity's markdowns reserve. We can only get this information at a sufficiently granular level through reports from the entity's enterprise

	resource planning or point-of-sale system. Therefore, we test controls to obtain evidence over the accuracy of markdown information and the completeness and accuracy of the entity's report for use in our substantive procedures.
The entity transacts electronically with third parties. Sales and purchases are automatically recorded between the entity and third parties, with little or no manual intervention.	• An entity's customers buy software services direct from its website, with little or no manual intervention. The entity's recorded revenues are generated directly through these website sales. It receives daily sales summary reports but cannot trace individual transactions to their source. • An entity conducts much of its business with vendors or customers over the web — e.g. when the entity places an order, its IT system automatically sends the order information to the vendor. The IT system then automatically matches the receipt and makes payment without manual intervention.
The entity uses a model to develop complex accounting estimates using data comprised of many small balances resulting from a high volume of transactions.	• Data used in developing a complex expected credit loss provision for a financial institution or a utility entity.

What do we do if substantive procedures alone cannot provide sufficient appropriate audit evidence and the control activities related to the RMM are ineffective? [ISA | 597.8596]

If we assess control risk as no controls reliance for an RMM where we are unable to obtain sufficient appropriate audit evidence from substantive procedures alone, then we have a scope limitation for that RMM. We perform procedures in accordance with 'Modify the audit opinion for specific circumstances'.

Example

When might substantive procedures alone not provide sufficient appropriate audit evidence? [ISA | 597.1500]

Example 1 | Manufacturing entity [ISA | 597.10976]

Fact pattern:

Entity A issues electronic purchase orders to its suppliers, and receives the related supplier invoices electronically. Entity A records the receipt of goods by scanning a supplier barcode on the received parcel. This initiates an automated process to match the purchase order price and quantity against the invoice price, quantity and barcode reference number.

The receipt is recorded in the inventory system, and the payable in the payables system. Both amounts are transferred to the general ledger. Given the automated nature of its process, Entity A does not retain hard copy receiving documents.

Analysis:

The process is highly automated and relies on evidence that only exists in electronic form — i.e. electronic invoices and purchase orders. Therefore, substantive procedures alone may not provide sufficient appropriate audit evidence.

As a result, the engagement team identify and test those automated process control activities and general IT controls that support the effective operation of these automated control activities. Otherwise, they may not obtain sufficient appropriate evidence in response to the identified risk.

Example 2 | Bank [ISA | 597.10977]

Fact pattern:

Bank J relies heavily on IT systems to process deposit transactions. These transactions are captured through various means, including branch tellers, automated clearing house (ACH) transactions, wire transfers, automated teller machines (ATMs), telephone, online banking and correspondent banks.

We have identified the following RMM:

Deposits are not recorded as liabilities at the time they are received by the entity.

As part of our substantive procedures to address this RMM, we plan to perform procedures over the daily deposit suspense/transit account reconciliations at period end.

Analysis:

The process is highly automated, and relies on evidence that only exists in electronic form — i.e. checks deposited in the bank, wire transfers, ACH transactions, ATMs, branch tellers. Therefore, substantive procedures alone may not provide sufficient appropriate audit evidence.

As a result, the engagement team identify and test those automated process control activities and general IT controls that support the effective operation of these automated control activities. Otherwise, they may not obtain sufficient appropriate evidence in response to the identified risk.

1.3 Test control activities to support the accuracy and completeness of financial information, when necessary [ISA | 598]

What do we do?

IF we plan to rely on the accuracy and completeness of financial information used in further audit procedures AND do not perform other procedures over the completeness and accuracy THEN perform test of control activities over that information.

Why do we do this?

Sometimes the way to evaluate the accuracy and completeness of an entity's system generated report is to test control activities over the generation of the report and the accuracy and completeness of the information it includes. Otherwise, we will be unable to obtain sufficient appropriate audit evidence to conclude on an RMM. When that's the case, and when we use the report for our substantive procedures, we test the entity's controls over the accuracy and completeness. If we fail to obtain evidence over the accuracy and completeness of the information, we will have relied on the entity's controls without testing the operating effectiveness of them.

Execute the Audit

When do we rely on accuracy and completeness of financial information used in performing other audit procedures? [ISA | 598.1300]

We rely on accuracy and completeness of financial information or the relevant data element when we use this information as an input in our substantive procedures. This information is not the financial information being audited. A common example is when we use reports when performing substantive analytical procedures. In that situation, testing control activities may be necessary to support our reliance on the accuracy and completeness of this information or data elements.

In addition, we rely on accuracy and completeness of financial information or the relevant data element when the information is used in the performance of the relevant control activities we plan to rely on.

How can we support our reliance on the accuracy and completeness of financial information or relevant data element in a financial statement audit? [ISA | 598.1400]

In a financial statement audit, we are able to evaluate whether the financial information or relevant data elements are accurate and complete by following the procedures in the activity 'Determine the appropriate audit procedures to address the reliability of the Information.'

When do we test controls over the accuracy and completeness of financial information or relevant data elements? [ISA | 598.1700]

We test the control activities related to the accuracy and completeness of financial information or relevant data element when:

- we are unable to obtain persuasive (sufficient and appropriate) evidence through other audit procedures (i.e. testing the information directly); or
- we decide that it is more effective and efficient to test the control activities than testing the information or relevant data elements directly.

When are we unable to obtain persuasive (sufficient and appropriate) evidence through other procedures? [ISA | 598.2000]

When information or data elements are generated from the entity's IT system or are otherwise prepared in a highly automated manner, we are unable to obtain sufficient appropriate audit evidence from substantive procedures alone. For example, a website company that generates revenue by click-through. As a result, the only way in which we can adequately test these types of information or data elements is by testing and relying on control activities.

Examples

How may we obtain evidence over the accuracy and completeness of information used in substantive procedures? [ISA | 598.2100]

Fact pattern

An engagement team is designing and performing audit procedures over an RMM related to the existence of revenue with a combined audit risk (CAR) assessed as BN. The entity is a retail company and retail revenue is considered predictable.

The team performs a substantive analytical procedure and develops an expectation of current year (CY) net sales, taking into account prior year (PY) information as follows:

(PY net sales revenue ÷ PY average monthly square footage) × CY average monthly square footage = expected CY net sales

Note: For example purposes, the impact of inflation has not been included.

Analysis

The team considered the completeness and accuracy of each of the inputs into the substantive analytical procedure as follows:

- **PY net sales revenue** was obtained from the general ledger and included within the period year audit documentation. In the prior year's financial statement audit the team performed audit procedures over net sales.
- **PY average monthly square footage** was obtained from the square footage schedule in the prior year audit documentation. The square footage schedule was derived from the store operating lease management system.
  - The operating lease system does not drive the recognition of net sales, as it does not interface with the ERP system, is separately maintained and includes different processes, risks, and controls.
  - The prior year average monthly square footage was evaluated for reliability during the preceding audit by evaluating the design and implementation and testing operating effectiveness of the control activities over the accuracy and completeness of this information.
- **CY average monthly square footage** was obtained from the current year square footage schedule included within the current year audit documentation. The square footage schedule was derived from the store operating lease management system, which as noted above does not interface with the ERP system or drive the recognition of net sales.

  In the current year, the team did not take a controls approach to testing the RMM or the RMM's associated with leases. They therefore did not test process control activities over the operating lease management system, or the completeness and accuracy of the reporting square footage in the management report.

  Because the team did not directly test the report or test the control activities over the accuracy and completeness of the lease report, they inadvertently place reliance on internal information that may not be reliable. The end result is that they may not sufficiently reduce their audit risk, or may reach an incorrect conclusion, and may not achieve their objective for the audit.

The team's options to evaluate the reliability of the current year square footage inputs to their substantive analytical procedure include:

- directly testing the accuracy and completeness of current year square footage reports used in their substantive procedures, based on evidence like lease agreements; or
- re-evaluating their decision to not test the relevant control activities and testing the control activities over the accuracy and completeness of the reports used and the related process control activities in lease management system.

1.4 Perform procedures to address the identified fraud risk associated with the SUT [ISA | 831]

What do we do?

Perform procedures to address the identified fraud risk associated with the significant unusual transactions.

Why do we do this?

Similar to significant risks due to error, we perform specific procedures that directly respond to fraud risks.

Fraud risks are significant risks, so we obtain more persuasive evidence over them by altering the nature, timing and extent of our audit procedures. If we don't, we may reach the incorrect conclusion.

Execute the Audit

How do we respond to an identified fraud risk? [ISA | 831.1300]

Refer to guidance related to our procedures to address an identified fraud risk .

What incremental procedures might we perform over a SUT with assessed fraud risk? [ISA | 831.1400]

Examples of procedures to obtain more persuasive audit evidence related to a SUT assessed with fraud risk may be:

- confirming contract terms and agreements with third parties;
- confirming amendments to contract terms and agreements or side agreements with third parties;
- involving another professional to assess the authenticity of contracts and agreements;
- investigating the possibility of related parties involved in the transaction and the sources of financial resources supporting the transaction.

1.5 Determine the approach to evaluate the reliability of internal information [ISA | 2695]

What do we do?

Determine the approach to evaluate the reliability of internal information and RDEs

Why do we do this?

Internal information is generally less reliable than external information obtained from knowledgeable independent third parties because it is sourced from the same systems and controls as the financial information we audit and may be subject to management bias. If this information is not sufficient or appropriate, it could affect the conclusions we draw when designing and performing audit procedures.

Execute the Audit

When do we test internal information for control activities? [ISA | 2695.1300]

We test internal information and RDE(s) when the information is sufficiently relevant, and at a minimum, when it is being used to test a control activity (including automated process control activities and GITCs) or used to support the account being tested in a substantive procedure.

How do we test the reliability of internal information? [ISA | 2695.1400]

We test the reliability of internal information by testing the accuracy and completeness of the information.

What does 'accurate and complete' mean in the context of internal information? [ISA | 2695.11581]

When internal information is referred to as being 'accurate and complete' in the context of reliability of information, we are not referring to the accuracy and completeness assertions in the CEAVOP model, but rather this means that such information:

- contains *all* the data that is necessary
- contains *only* the data that is necessary
- contains data that is correct.

'Accuracy' in this context also relates to the way the data is manipulated and presented in a report - e.g. groupings, calculations based on the data, and totals in the report.

What does 'validity' mean in the context of information and how does it relate to our risk assessment and our evaluation of the accuracy and completeness of information? [ISA | 2695.8517]

Validity means that recorded transactions represent economic events that actually occurred or were executed according to prescribed procedures. Validity is generally achieved through process control activities that include the authorization of transactions as specified by an entity's established policies and procedures (that is, approval by a person having the authority to do so.)

We obtain an understanding of how transactions are authorized when we obtain our understanding of the flow of transactions within a business process, including the flow of information. This includes understanding how transactions are initiated, authorized, processed, and recorded in systems, until reflected in the entity's financial records. Our understanding provides a basis for us to identify and assess RMMs.

Accuracy, completeness, and validity represent risks that exist within an entity's information system that we take into consideration when identifying process risk points (PRPs) and/or risks arising from IT (RAFITs) and the control activities which address the PRPs/RAFITs (see question 'Which control activities do we understand and are relevant to the audit?' for further information).

Do we always test the 'authorization' of transactions and other information? [ISA | 2695.8518]

No. Validity is generally achieved through control activities; therefore, we only test for authorization when we decide to evaluate the design and implementation or test the operating effectiveness of control activities.

What are the approaches to testing the accuracy and completeness of the internal information? [ISA | 2695.1500]

We test the accuracy and completeness of internal information by using the following approaches:

- *Controls approach:* we test management's controls over the accuracy and completeness of the internal information;
- *Direct-testing approach*: we directly test the accuracy and completeness of the internal information; or
- *Mixed approach*: we may use both a controls approach and a direct-testing approach to obtain evidence over the accuracy and completeness of the internal information.

  In understanding the flow of the data into the information, which we always do as a first step, we may determine that we can test control activities over part of the flow and directly test the data in the rest of the flow. For example, we may either:

  - test the control activities over data input and data integrity and then directly test that the data we use agrees to the data in the system (i.e. data extraction and manipulation); or
  - directly test that the data in the system agrees to source documents (i.e. data input) and then test the control activities over data integrity and the extraction and presentation of the data in the report (i.e. data extraction and manipulation).

What do we think about when determining the testing approach for data sourced from Electronic Data Interchange (EDI)? [ISA | 2695.8521]

Electronic feeds of data (also referred to as EDI) are generally information obtained from external sources which:

- may be used by the entity to initiate the recording of transactions (e.g. a sales order or a cash collection may be electronically sent by the customer or a bank and electronically interfaced into the entity's systems), and
- may provide audit evidence of transactions occurring.

Although electronic feeds are from an external source, once they are processed through an electronic interface and are automatically input into and maintained in the entity's system, they are considered internal information and may be the only information available to support an underlying transaction. In these circumstances, when we plan to evaluate the reliability of data sourced from EDI, it may not be possible to directly test them to external source documents (i.e. we cannot gain sufficient evidence over the reliability of the data through direct testing alone) and we evaluate that information by testing controls over the EDI data input and data integrity (e.g. automated process control activities over the EDI and related supporting GITCs).

How do we determine which approach to take to test the accuracy and completeness of the internal information? [ISA | 2695.11582]

The table below lists circumstances when a specific approach is taken:

Circumstances where a specific approach is applied	Specific approach to test the accuracy and completeness of the information
When we have determined that we cannot gain sufficient evidence over the reliability of the data through direct testing.	Controls approach or mixed approach
When data is directly disclosed in the financial statements, irrespective of whether we test control activities or not.	Direct testing approach - even when we test control activities in these circumstances, we also direct-test the data.

In all other situations, we have optionality in the approach depending on the determined audit strategy. To decide, we weigh the benefit and cost of testing controls. To help with this determination, we may analogize to the guidance on determining whether to take a controls based approach or a substantive based approach in our audit of the financial statements.

2 Consider performing a dual-purpose test [ISA | 1301]

What do we do?

IF we are performing test of controls THEN consider performing a dual-purpose test that is designed to achieve both control and substantive test objectives AND evaluate the results of the dual-purpose test separately

Why do we do this?

Performing dual-purpose tests can be beneficial because we can use the same items for both tests. We may save time and increase the effectiveness of our audit by thinking about when dual-purpose tests may be possible during audit planning.

Dual-purpose testing does not mean performing a substantive procedure and then inferring from the results that a control is effective. Similarly, the effectiveness of a control is not inferred if we did not identify any misstatements when we perform our substantive procedures. Instead, a dual-purpose test is specifically designed to test both objectives using the same transactions.

Execute the Audit

What is a dual-purpose test? [ISA | 1301.1300]

A dual-purpose test is when we perform both a test of operating effectiveness of a control and test of details on the same transaction. This approach provides evidence for both tests instead of making two separate and distinct item selections from the same population and allows us achieve the objectives of both tests concurrently using the same transactions.

For example, we are performing tests to address the risk that inventory may be misstated because of an error in the quantity of raw materials inventory on hand. We are looking to observe

and/or reperform the control of the inventory count, and we also want to observe and/or reperform the inventory count as a substantive procedure. In both tests, we are looking to obtain similar audit evidence, and one test may be appropriate to address both objectives.

When may we perform a dual-purpose test? [ISA | 1301.10534]

We may perform a dual-purpose test when:

- the population over which we are performing the tests is the same; or
- the type of audit evidence sought to address the applicable process risk point(s) associated with the control and the risk of material misstatement (RMM) is similar.

In these situations, it may be easier to combine the procedures for both separate tests and apply them to the same sample of transactions.

Even when the control and substantive procedures are not the same, we may be able to perform a dual-purpose test.

For example, we're performing procedures to address an RMM related to revenue: Elements of the transaction price are not completely and accurately identified.

As part of our control testing procedures, we inspect a sample of sales invoices recorded to determine that an appropriate individual had approved the invoice and re-perform the check that the quantities and prices in the customer's purchase order agree to the invoice (because there is a control in place that matches an invoice to the purchase order).

However, as part of our substantive procedures, we inspect the amount and terms of the invoice and compare them to how they are recorded in the financial statements. In this instance, it may be more efficient for us to obtain one selection of invoices and perform both procedures on each item selected, because even though the objective of the control and substantive tests may be slightly different, the population of invoices and purchase orders contain all the information to perform both tests.

However, if the items we select are not appropriate for both types of tests, it may be an indication that a dual-purpose test may not be appropriate.

How do we design the dual-purpose test to achieve both control and substantive test objectives? [ISA | 1301.10535]

When we design a dual-purpose test to achieve both control and substantive test objectives, we think about whether:

- The procedure achieves the substantive test's objective - i.e. do the procedures we perform respond to the risks of material misstatement (RMMs)?
- The procedure achieves the control test's objective - i.e. do the procedures we performed relate to the attributes of the control that appropriately address the applicable process risk point (PRP)?

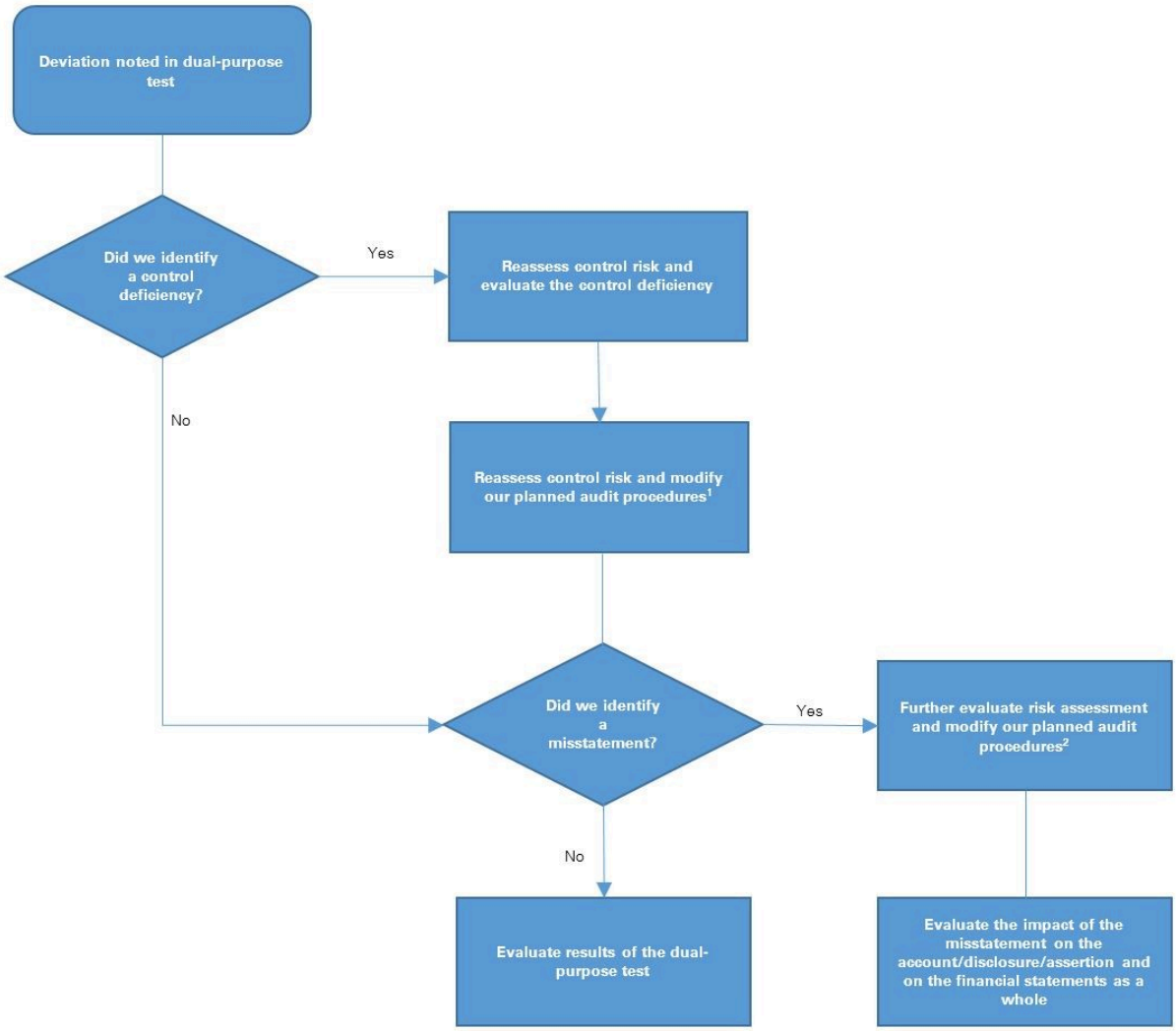
If we are using audit sampling to select the items to be tested then we determine the sample size in accordance with 'Determine the substantive sample size ' and 'Determine the control sample size '.

How do we evaluate the results of a dual-purpose test? [ISA | 1301.10536]

We evaluate the results of a dual-purpose test separately, because we're relying on controls to alter the nature, timing and extent of substantive procedures. If we did not evaluate the effectiveness of the control we're testing, we could inadvertently assess CAR at too low a level and not obtain sufficient appropriate audit evidence to address the risks of material misstatement (RMM).

What if we identify a misstatement and/or deviation in a dual-purpose test?

The following flowchart explains what we do if we identify a misstatement and/or deviation in a dual-purpose test:



[1] See activity 'In response to control deficiencies, test other controls or modify control risk and substantive testing '

[2] See activity 'Evaluate our risk assessment and modify planned substantive procedures for contradictory evidence '

3 Test the operating effectiveness of controls [ISA | 603]

What do we do?

IF we conclude a control is designed effectively AND we plan to test its operating effectiveness, THEN design and perform procedures to directly test that the control is operating as designed

Why do we do this?

Tests of operating effectiveness provide evidence to support our preliminary control risk assessment as Controls Reliance and in an integrated audit support the objective of our audit of ICFR.

We test controls directly because we can't assume that a control is operating effectively just because our substantive procedures don't identify a misstatement.

Execute the Audit

Which controls do we test for operating effectiveness? [ISA | 603.1300]

We test the operating effectiveness of controls when:

- we are conducting an integrated audit;
- we plan to rely on the process control activity to reduce our Combined Assessed Risk (CAR) for a RMM (i.e., when we take a controls based approach);
- the general IT control supports the effective operation of automated controls that we intend to rely on;
- substantive procedures alone cannot provide sufficient appropriate audit evidence to address a RMM; or
- it is necessary to support the accuracy and completeness of information relevant to the audit.

When we are determining which controls to test, we also consider whether there are relevant control activities at the service organization that impact the entity's business processes. Although we may not test controls at the service organization, when we plan to rely on relevant control activities at the service organization we perform procedures (e.g. review the Type 2 SOC report) to determine whether the controls are operating effectively to achieve the control objective and also decide whether we can place reliance on those control objectives in designing our substantive procedures (see activity "Test the operating effectiveness of controls at the service organization" for further information).

Regardless of the above circumstances, we do not test the operating effectiveness of controls that are ineffectively designed or have not been implemented.

How do we design procedures to test the operating effectiveness? [ISA | 603.1400]

We design procedures that directly test the operating effectiveness of controls so we can obtain evidence about how the controls were applied and the consistency with which they were applied. We do so based on the nature and design of the control.

How do we test a control directly? [ISA | 603.1500]

Testing a control *directly* means that we perform specific procedures that test whether the control is operating as designed. We do not infer or assume that controls operate effectively merely because we haven't identified misstatements when performing substantive procedures.

Can we perform a dual-purpose test - e.g. a substantive test and a test of a process control activity concurrently? [ISA | 603.1800]

Yes. In some cases, we may choose to perform a dual-purpose test- e.g. a substantive test and a test of a process control activity concurrently. In doing so, we are careful not to assume the effective operation of controls based on the results of substantive procedures. Instead, we design dual-purpose tests to obtain evidence that accomplish the objectives of both tests at the same time, by obtaining independent evidence that the underlying transaction or balance is reasonably stated, and that management's control over the same transaction operated as it was designed.

When do we conclude a control is operating effectively? [ISA | 603.1900]

Simply stated, a control operates effectively when it is designed effectively and operating consistently as designed. Accordingly, we do not test the operating effectiveness of controls if we have concluded that the control is not designed effectively.

3.1 Design procedures over controls to obtain persuasive evidence [ISA | 600]

What do we do?

Design procedures to obtain more persuasive audit evidence from the tests of controls the greater the RAWTC

Why do we do this?

When testing the operating effectiveness of controls, we determine the persuasiveness of evidence to obtain by considering the risk associated with the control (RAWTC). Using this information, we plan the nature, timing and extent of our procedures, perform those procedures, and address the rollforward period if applicable. These successive steps allow us to conclude on Control Risk, which is an input to Combined Assessed Risk (CAR) and in an integrated audit support the objective of our audit of ICFR.

Execute the Audit

How do we design and perform procedures over controls to obtain persuasive evidence? [ISA | 600.1300]

To design and perform procedures over controls, we:

(1) Assess the risk associated with the control to determine the level of evidence necessary to conclude on the operating effectiveness of the control.
(2) Incorporate knowledge from past audits.
(3) Determine the nature of tests of controls to obtain persuasive audit evidence.
(4) Determine the timing of tests of operating effectiveness of controls to obtain persuasive audit evidence.
(5) Determine the extent of procedures over controls to obtain persuasive audit evidence.
(6) Obtain evidence about the operating effectiveness of controls.
(7) Determine additional evidence for the rollforward period, if applicable.
(8) Determine the effect of any identified control deviations.

How do we determine the level of evidence necessary to conclude on the operating effectiveness of controls? [ISA | 600.1400]

The level of evidence necessary to conclude on the operating effectiveness of controls is a matter of auditor judgment. We consider the risk associated with the control (RAWTC) when making that judgment.

When do substantive procedures alone not provide sufficient, appropriate audit evidence? [ISA | 600.1500]

Substantive procedures alone may be insufficient to conclude on an RMM when we cannot obtain sufficient, appropriate evidence without relying on the entity's controls and processes. This can be the case in technology-dependent processes, when sufficient evidence is not available except in electronic form or through the entity's information systems.

> For example, when a customer places a purchase order directly on an entity's website, the only substantive evidence of a contractual arrangement might depend on the entity's process control activities over the complete and accurate capture of the purchase order. We may not be able to perform a substantive test of details that provides sufficient appropriate audit evidence without also obtaining evidence about the entity's process control activities over the input and integrity of relevant data in the customer purchase order.

In situations where we test controls because substantive procedures alone cannot provide sufficient appropriate evidence, this doesn't necessarily mean we obtain more persuasive evidence for all process control activities that address the process risk points related to a risk of material misstatement. Rather, we obtain more persuasive evidence for those process control activities that we determine are necessary to test as a result of the characteristic that led us to conclude that substantive procedures alone cannot provide sufficient appropriate audit evidence.

How do we obtain more persuasive audit evidence? [ISA | 600.1600]

To obtain more persuasive audit evidence, we modify the nature, timing and extent of the procedures we perform to test the operating effectiveness of the control.

Nature	The type of control evidence we obtain.
Timing	When we perform our control test. Tests of controls obtain evidence about the effectiveness of controls for the entire period of reliance.
Extent	The sample size. The more extensively a control is tested, the more persuasive the evidence obtained.

3.1.1 Assess RAWTC [ISA | 601]

What do we do?

Assess the risk associated with the control (RAWTC)

Why do we do this?

To determine the persuasiveness of evidence necessary to conclude on the operating effectiveness of the control, we assess the risk associated with the control (RAWTC) at Base, Elevated, Significant or Significant+. This assessment helps us to adjust the nature, timing and extent of our audit procedures.

Execute the Audit

What is RAWTC? [ISA | 601.1300]

The risk associated with the control (RAWTC) is the risk that the control might not be effective, and if not effective, that a material misstatement (or material weakness when performing an audit of internal control over financial reporting) may result.

What are the different levels of RAWTC? [ISA | 601.1400]

We assess RAWTC at Base, Elevated, Significant or Significant+ in order to determine the persuasiveness of evidence necessary to conclude on the operating effectiveness of the control.

How does RAWTC affect the persuasiveness of evidence we obtain to test the operating effectiveness of the control? [ISA | 601.1500]

As RAWTC increases, we obtain more persuasive evidence to determine that the control is effective.

What do we do to assess RAWTC for relevant controls? [ISA | 601.1700]

In practice, how we assess RAWTC depends on whether the relevant control is a:

- process control activity; or
- general IT control.

3.1.1.1 Assess RAWTC for process control activities [ISA | 1267]

What do we do?

Assess the risk associated with the control as Base, Elevated, Significant or Significant+, based on the inherent risk of the associated RMM and other specific factors that may increase the risk that the process control activity is not effective.

Why do we do this?

To determine the persuasiveness of evidence necessary to conclude on the operating effectiveness of the process control activity, we assess the risk associated with the control (RAWTC) at Base, Elevated, Significant or Significant+. This assessment helps us to adjust the nature, timing and extent of our audit procedures.

Execute the Audit

How do we assess RAWTC for process control activities? [ISA | 1267.1400]

In practice, we assess RAWTC for process control activities in two steps:

(1) Start with inherent risk for the related risk of material misstatement (RMM).
(2) If necessary, adjust preliminary RAWTC upward to determine our assessed RAWTC, by considering specific factors that may indicate an increased risk that a process control activity is not effective.

What if the process control activity addresses multiple RMMs? [ISA | 1267.12066]

If the process control activity addresses multiple RMMs, start with the highest inherent risk among them. This will be our preliminary RAWTC.

> For example, if a process control activity addresses both an RMM with Base inherent risk and an RMM with Elevated inherent risk, then our preliminary RAWTC is Elevated.

By assessing preliminary RAWTC based on the inherent risk for the related RMM, we incorporate both the nature and materiality of misstatements that the process control activity is intended to prevent or detect and the inherent risk associated with the related accounts and assertions.

What other factors do we consider in step 2 when assessing RAWTC for process control activities? [ISA | 1267.12067]

We consider the below factors to determine whether it is necessary to adjust our preliminary RAWTC upward as part of step 2. The importance of these factors may vary depending on both the degree to which they are present and the process control activity itself. No single factor is determinative in making an adjustment.

Assessed RAWTC will not always be the same as the inherent risk for the related RMM because we consider these specific factors and when we assess RAWTC as Significant, this does not necessarily mean that the control addresses a significant risk.

Factor	Indicator of Base RAWTC	Indicator of Elevated RAWTC	Indicator of Significant or Significant+ RAWTC
Whether we are testing the process control activity because substantive	A process control activity that is *not* being tested because substantive	A process control activity that *is* being tested because substantive procedures alone would not be sufficient	

procedures alone will not be sufficient	procedures alone would be sufficient		
Whether there have been changes in the volume or nature of transactions that might adversely affect the design or operating effectiveness of the process control activity	A process control activity where there has been no or minimal changes in the volume or nature of transactions that might adversely affect the design or operating effectiveness	A process control activity where there have been changes in the volume or nature of transactions that might adversely affect the design or operating effectiveness	A process control activity where there have been significant changes in the volume or nature of transactions that might adversely affect the design or operating effectiveness
Whether the related account has a history of errors	A process control activity related to an account that has not had a history of errors	A process control activity related to an account that has had a history of errors	
Whether there are deficiencies in CERAMIC, especially in the Monitoring Activities component	A process control activity at an entity with no identified deficiencies in the Control Environment, Risk Assessment, Monitoring or Information and Communication (CERAMIC) components of internal control over financial reporting (ICFR)	A process control activity at an entity with few identified deficiencies in the CERAMIC components of ICFR, which did not aggregate to a significant deficiency and/or material weaknesses	A process control activity at an entity with significant issues - e.g. significant deficiencies and/or material weaknesses - in the CERAMIC components of ICFR
The nature of the process control activity and the frequency with which it operates	A process control activity that operates in a non-complex manner and occurs on a frequent basis	A process control activity that operates in a non-complex manner but occurs infrequently	A process control activity that operates in a more complex

			manner and occurs infrequently
The degree to which the process control activity relies on the effectiveness of other controls — e.g. the control environment or general IT controls	A process control activity that relies on few or no other controls to operate effectively	A process control activity that relies on multiple other controls to operate effectively	A process control activity that relies on a significant number of other controls to operate effectively
The competence of the personnel performing the process control activity or monitoring its performance, and any changes in the key personnel	A process control activity that is performed by personnel experienced in performing the process control activity and competent/qualified in their role	A process control activity that is performed by personnel who are competent/qualified in their role but have no experience in performing the process control activity	A process control activity where there has been variability and turnover in the personnel performing the process control activity, or there are potential issues with the competence/ qualifications of the individual(s) performing the process control activity
Whether the process control activity is performed manually or is automated - i.e. we would generally expect an automated process control activity to be lower risk if relevant general IT controls are effective	An automated process control activity supported by relevant, effective general IT controls	A process control activity that is manual but is not subject to judgment	A process control activity that is manual and is therefore subject to variability in execution and human error
The complexity of the process control activity and the	A routine process control activity with control attributes	A routine process control activity with control attributes that	A complex process control activity with control

significance of the judgments made about its operation	that involve little judgment or subjectivity from the control operator	involve moderate judgment or subjectivity from the control operator	attributes that involve significant judgment from the control operator
The results of the previous years' testing of the process control activity — i.e., whether deficiencies were identified in the prior years	A process control activity where no deficiencies were identified in the prior years	A process control activity where deficiencies were identified in the prior year	
Whether there have been changes in the process control activity or the process in which it operates since it was previously tested	A process control activity where there been no or minimal changes in the process control activity or the process in which it operates since it was previously tested	A process control activity where there been changes in the process control activity or the process in which it operates since it was previously tested	A process control activity where there been significant changes in the process control activity or the process in which it operates since it was previously tested

Can our assessment of RAWTC for process control activities be less than our assessment of inherent risk for the RMM? [ISA | 1267.1500]

No. RAWTC for process control activities can be equal to or greater than the inherent risk for the RMM(s) it relates to - but not less than it.

However, when testing the operating effectiveness of a process control activity that solely addresses the reliability of information, we do not start with preliminary RAWTC equal to the inherent risk of the RMM(s) where the information is used, rather we assess RAWTC by considering the RAWTC factors. See question - 'What other factors do we consider in step 2 when assessing RAWTC for process control activities?' for the RAWTC factors.

Can our assessment of RAWTC for process control activities be greater than our assessment of inherent risk for the RMM? [ISA | 1267.1600]

Yes. RAWTC of a process control activity can be greater than the inherent risk for the RMM. For example, if our inherent risk is Elevated, we may assess RAWTC anywhere from Elevated to Significant+.

Inherent risk is only one factor in our assessment of RAWTC; however, we also consider other factors that could indicate a higher RAWTC. Inherent risk for the related accounts and assertions is itself a key factor in assessing RAWTC, and many of the same factors we consider in assessing inherent risk

- likelihood and magnitude of possible misstatements, judgment and/or complexity in the accounting process - are also factors that impact the RAWTC. When considering these other factors, remember that the assessed inherent risk for the RMM may already incorporate the consideration of some of these other factors so we do not 'double count' certain factors and inadvertently increase RAWTC.

Why do all process control activities addressing the same RMM start with the same RAWTC? [ISA | 1267.1700]

All process control activities addressing a particular RMM start with the same RAWTC because our first step in assessing RAWTC is to consider the inherent risk for the related RMMs.

Since not all process control activities have the same degree of complexity, history of errors or other factors relating to the risk, we evaluate the other factors separately on a per-control basis. As a result, some of the process control activities related to a particular RMM could have a higher RAWTC.

If we only focused on the risk that a control could fail (i.e., not be effective), RAWTC may not be as directly tied to inherent risk. But since RAWTC also considers the risk that a material misstatement could result if the control is not effective, then the likelihood and magnitude of misstatements - i.e. inherent risk - is the best starting point.

What if we test process control activities because substantive procedures alone cannot provide sufficient appropriate evidence? [ISA | 1267.1800]

In situations where we test process control activities because substantive procedures alone cannot provide sufficient appropriate evidence, we rely more on the effectiveness of those controls.

We therefore obtain more persuasive evidence that they are operating effectively, by assessing RAWTC at either Elevated, Significant or Significant+, depending on our inherent risk assessment and other factors. A RAWTC assessment of Base is not appropriate in these circumstances.

When we test process control activities because substantive procedures alone cannot provide sufficient appropriate evidence, we don't necessarily obtain more persuasive evidence for all process control activities that address the process risk points — only those with characteristics that led us to conclude that substantive procedures alone were insufficient.

Can the results of substantive procedures affect our assessment of RAWTC? [ISA | 1267.1900]

It depends. We typically test relevant control activities prior to designing and performing substantive audit procedures. We therefore make an initial assessment of RAWTC based on information known when we test the process control activity, including whether the account has a history of errors.

In certain circumstances substantive testing may provide insight into the factors we used to determine RAWTC. In these circumstances we consider the effect on our assessment of RAWTC and the nature, timing, and extent of both tests of controls and substantive procedures. For example, if misstatements are identified when performing substantive procedures, we might reconsider the RAWTC factor related to whether the account has a history of errors. Similarly, an absence of misstatements from our performance of substantive procedure informs our risk assessment.

3.1.1.2 Assess RAWTC for general IT controls [ISA | 1268]

What do we do?

Assess the risk associated with the control (RAWTC) for general IT controls as Base, Elevated, Significant or Significant+.

Why do we do this?

To determine the persuasiveness of evidence we obtain to conclude on the operating effectiveness of a general IT control (GITC), we assess the risk associated with the control (RAWTC) as Base, Elevated, Significant or Significant+. We then adjust the nature, timing and extent of our audit procedures to obtain this evidence.

Execute the Audit

How do we assess RAWTC for general IT controls? [ISA | 1268.1300]

We assess RAWTC for general IT controls (GITCs) as follows:

- For GITCs that support the effective operation of automated controls, we consider the following factors:
  - the extent to which the GITC supports the effective operation of the related automated control(s)(see sub-question 'How do we consider the extent to which a general IT control supports the effective operation of automated controls?'); and
  - factors that affect the risk associated with the GITC, including those in the table below.
- For GITCs that address data integrity risks when evaluating the reliability of information used in the audit, since these GITCs are not supporting the effective operation of automated controls, we consider the factors that affect the risk associated with the GITC, including those in the table below.

The importance of the factors in the table below may vary depending on both the degree to which they are present and the GITC itself. No single factor is determinative in assessing RAWTC.

Factor	Indicator of Base RAWTC	Indicator of Elevated RAWTC	Indicator of Significant or Significant+ RAWTC
Whether there are deficiencies in CERAMIC, especially in the Monitoring Activities component	An entity with no identified deficiencies in CERAMIC	An entity with few identified deficiencies in CERAMIC, which do not aggregate to a significant deficiency	An entity with significant issues, e.g. significant deficiencies in CERAMIC
The nature and frequency of the general IT control	A general IT control that operates in a non-complex	A general IT control that operates in a non-complex	A general IT control that operates in a more complex

	manner and occurs on a frequent basis	manner but occurs infrequently	manner and occurs infrequently
The competence of the personnel performing the general IT control or monitoring its performance, and any changes in the key personnel	A general IT control that is performed by personnel experienced in performing the control and competent/qualified in their role	A general IT control that is performed by personnel who are competent/qualified in their role but have no experience in performing the control	A general IT control where there has been variability and turnover in the personnel performing the control, or there are potential issues with the competence/ qualifications of the individual(s) performing the control
Whether the general IT control is performed manually or is automated	An automated general IT control supported by other relevant, effective general IT controls	A general IT control that is manual and is therefore subject to variability in execution and human error	
The complexity of the general IT control and the significance of the judgments made about its operation (see question 'Can general IT controls involve judgment?' for more information on judgment involved in GITCs)	A routine non-complex general IT control with control attributes that involve little judgment or subjectivity from the control operator, e.g. a general IT control related to the approval and authorization of new users or changes to user permissions	A routine complex general IT control with control attributes that involve moderate judgment or subjectivity from the control operator	A non-routine complex general IT control with control attributes that involve significant judgment from the control operator, e.g. a general IT control related to evaluating the impact of the development or acquisition of a new IT system on financial reporting processes and ICFR
The results of the previous periods' testing of the general IT control — i.e., whether	A general IT control where no deficiencies were identified in the prior periods	A general IT control where deficiencies were identified in the prior period	

deficiencies were identified in the prior periods			
Whether there have been changes in the general IT control since it was previously tested	A general IT control where there have been no or minimal changes in the control since it was previously tested	A general IT control where there have been moderate changes in the control since it was previously tested	A general IT control where there have been significant changes in the control since it was previously tested

How do we consider the extent to which a GITC supports the effective operation of automated controls? [ISA | 1268.10545]

When considering the extent to which a GITC supports the effective operation of automated controls, we think about the level of RAWTC (Base, Elevated, Significant or Significant+) for the automated control(s) that the GITC supports.

This doesn't mean that RAWTC for every GITC that supports an automated control is equivalent or higher than RAWTC for such automated control. Rather, we consider the relative importance of the GITC in addressing the RAFIT(s) that affect the related automated control. The more important the GITC is to the effective operation of the automated control, the more likely it is to have a RAWTC equal to or higher than RAWTC for such automated control.

However, for each automated control, we assess RAWTC for at least one GITC that supports the effective operation of the automated control at equal to or higher than the RAWTC for the related automated control.

For example, consider the automated process control activity for restricting the access to post and review journal entries. This automated process control activity has a Significant RAWTC. The automated process control activity is supported by several GITCs, each of which address the relevant RAFITs. Suppose that three of those GITCs are:

RAFIT	General IT control
1.2 APD - Logical access permissions (new or modified) are granted to users and accounts (including shared or generic accounts) that are inappropriate (i.e., unauthorized or not commensurate with job responsibilities)	A-1: Access provisioning control for new employees
1.3 APD - Logical access permissions are not revoked in a timely manner	A-2: Access de-provisioning control for terminated employees

1.4 APD - Logical access to users and accounts (including shared or generic accounts) that can perform privileged tasks and functions within IT systems is inappropriate (i.e., unauthorized or not commensurate with job responsibilities)	A-3: Privileged user access is appropriately restricted to authorized users

We consider that control A-3 has the greatest importance to the effective operation of the automated process control activity as privileged user access has the most pervasive impact. On that basis, without considering other factors that affect RAWTC, we may assess RAWTC for control A-3 as Significant or Significant+, and for controls A-1 and A-2 as Base.

3.1.2 Determine the nature of tests of controls [ISA | 1276]

What do we do?

Determine the nature of the tests of controls we will perform to provide evidence about the effectiveness of relevant controls.

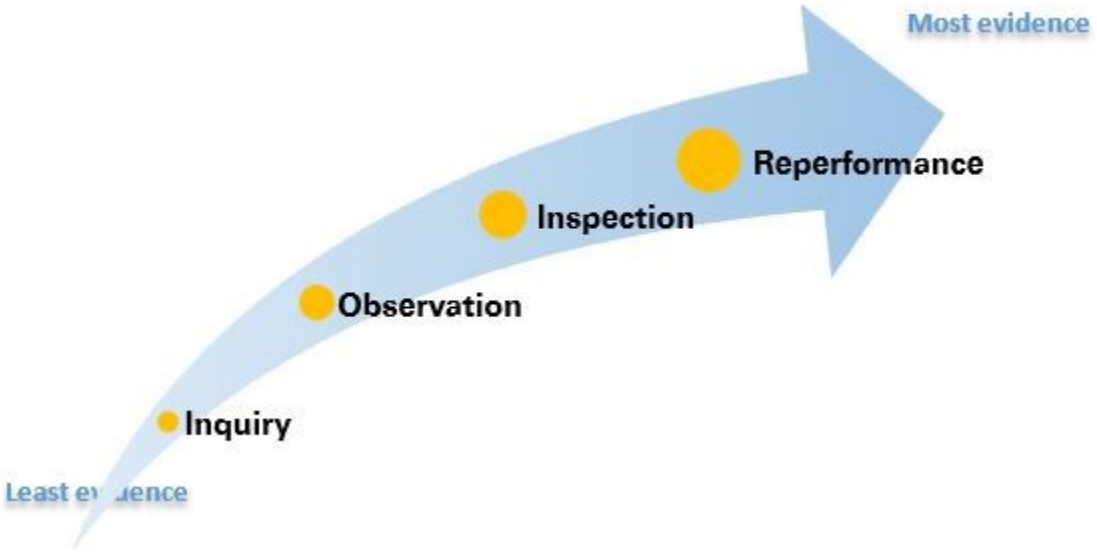
Why do we do this?

When we design and perform our procedures over the operating effectiveness of a control, we consider the risk associated with the control and the nature of the control to be tested. The greater the risk, the more persuasive audit evidence we obtain. We can vary the level of evidence we obtain to be responsive to the risk related to the control through changing the nature of control procedures (i.e., inquiry, observation, inspection, or reperformance) to be performed.

Execute the Audit

How might the nature of procedures vary when testing operating effectiveness? [ISA | 1276.1400]

The following diagram shows the different procedures we can perform to test the operating effectiveness of controls. The procedures are presented in order of the level of audit evidence they ordinarily provide, from least to most.



How do we obtain persuasive evidence to evaluate when testing operating effectiveness? [ISA | 1276.1500]

We obtain persuasive audit evidence to determine whether a control is operating effectively by performing either (or in combination):

- Reperformance is our independent execution of procedures or controls that were originally performed as part of the entity's internal control and entails using the same information as the control operator/IT system and seeing if we came to the same conclusion. We separately consider the reliability of the information used and cannot infer the performance of the control by comparison to independent information. If the control activity involves judgement the reperformance may involve using the control operators' metrics, thresholds or criteria independently to identify outliers or exceptions and then evaluate the control operator's follow-up on these items. When we reperform a control activity that involves judgement, we obtain sufficient documentation to showing that the control activity was in fact performed (including evidence that the control operator identified and resolved outliers, if any).
- Inspection may involve inspecting documents the operator uses in performing the control to obtain evidence to corroborate our inquiries and evaluating the effectiveness of the control as implemented by the control operator. This inspection goes beyond verifying that the review was performed and signed off by the reviewer.
- Observation involves looking at a process or procedure being performed by others - e.g. by observing key meetings or the performance of control activities.
- Inquiry may involve asking the person responsible for performing the control what they look for when performing it and what they do to address exceptions. We do not use inquiry as our only procedure.

Do we perform the same procedures over each control occurrence we test? [ISA | 1276.1600]

Yes. We perform the same procedures for each selected operation of the control. Our goal is to determine whether the control was executed in line with its design, each time it operated.

How do we decide what procedures to perform when testing a control? [ISA | 1276.1700]

When we determine which procedure(s) to perform when testing a control, we generally think about two primary factors:

- the nature and objective of the control itself; and
- our assessment of RAWTC.

These factors help us determine the evidence to obtain. As RAWTC increases, the sufficiency and appropriateness of evidence that the auditor obtains also increases. This means we are more likely to perform reperformance or a combination of multiple procedures to test controls with a higher RAWTC.

From a practical standpoint, we frequently use inspection or reperformance, or reperformance in combination with another procedure, when testing controls. Particularly when we test manual controls that occur with greater frequency, such as daily or recurring controls. This is because reperformance can generally be performed after the operation of a control, as opposed to observation and inspection which only provide evidence at the point in time they are performed (i.e. observing the performance of a manual reconciliation control or inspection of an automated information processing control as of a point in time).

However, when the nature of the control is such that observation and/or inspection can provide relevant audit evidence, we may determine that one or a combination of those procedures provides the right evidence to conclude the control is operating effectively.

How do we think about the nature and objective of the control when determining our procedures? [ISA | 1276.12069]

Certain procedures are better suited for a particular control simply because of the control's nature and objective. This includes how the control is performed, what the control is designed to prevent or detect and correct, and the type of documentation or evidence is generated when the control operates.

How do we think about the relevance of audit evidence to be obtained when determining our procedures? [ISA | 1276.12070]

We design our procedures so that they collect evidence that is relevant to determining if the control is actually working. In some cases, this may affect how we select items for testing (i.e. the population or transactions with specific characteristics that we select from). As we design our procedures, it can be helpful to step back and ask ourselves, "After performing this procedure, will we be able to evaluate if the control operated when it was supposed to and in the manner in which it was designed?" If not, this is likely an indicator that we ought to alter the nature of our procedures.

How does the extent of documentation generated by management in the performance of controls influence the design of our procedures? [ISA | 1276.12071]

The documentation generated through the operation of controls may be less formal at smaller, less complex entities, which may impact the nature of our audit procedures. When we are performing procedures at these entities and encounter situations where that documentation is less extensive or not prepared with the same level of formality as a larger, more sophisticated entity, we may alter our testing strategy and the nature of audit procedures to help us obtain sufficient audit evidence. For example, because there may not be as much documentation available to inspect, we may be able to combine our inspection procedures with observation and/or reperformance so that we can determine if the control is operating effectively.

While there are some instances where we may be able to modify our procedures to help us obtain sufficient evidence when less formal documentation exists, sufficient evidence still has to exist. If we are unable to obtain evidence that a control actually operates, then it is unlikely we could gather sufficient evidence that the control was operating effectively, no matter how we designed our procedures.

Consider a situation where we are testing management's controls and there is no evidence that any of the controls are actually being performed (i.e. no documentation generated from any control).

- Even if we inquired of management and reperformed all the controls, would we feel comfortable concluding that the controls were truly operating effectively?
- What if management hadn't performed any of the controls but had instead been lucky that there were no issues - how would we know the difference?

These questions may be useful to consider as we are evaluating those situations where an entity may have less extensive or less formal documentation.

Example

How might thinking about the evidence a test will generate impact the design of our procedures? [ISA | 1276.1800]

Fact pattern:

The engagement team is designing procedures to test an authorization control where disbursements over $100K are authorized by the CFO through signing and dating an invoice before it is paid. The team is thinking about the population it will use to select its sample for testing and initially plans to use the disbursement listing for the full year. After asking themselves whether they would be able to tell if the control operated when it was supposed to and in the manner in which it was designed when using the full population of disbursements, they determined it appropriate to adjust the population to be sampled to reflect only those disbursements in excess of the $100K referenced in the control design.

Analysis:

The engagement team determined it appropriate to adjust the population to be sampled to only those disbursements in excess of $100K, because the evidence obtained from the test relating to disbursements below that threshold would not be relevant to determining whether the control was operating effectively in accordance with its design (i.e. that the CFO was actually reviewing and approving invoices for disbursement over $100K). In this case, even if the engagement team had designed the nature of their procedures appropriately, by considering the nature and objective of the control as well as the assessed risk associated with the control, the team may not have obtained enough relevant audit evidence to conclude that the control is operating effectively if they had used the entire disbursement population for sampling and selected disbursements both above and below $100K as part of their sample for the test of control.

3.1.3 Determine the timing of tests of operating effectiveness of controls [ISA | 608]

What do we do?

Determine the timing of tests of operating effectiveness of controls

Why do we do this?

We plan the timing of our control tests so we can effectively and efficiently sequence our audit to obtain sufficient appropriate evidence. This planning includes determining:

- when we obtain our evidence about the operating effectiveness of controls;
- the period of time to which our procedures apply;
- whether we will obtain evidence about the operating effectiveness of controls at an interim period and whether we will conclude on the operating effectiveness as of the interim period; and
- whether we will use audit evidence about the operating effectiveness of automated controls (excluding GITCs) from the prior period.

Execute the Audit

What do we consider when we determine the timing of our tests of controls? [ISA | 608.1300]

When we are determining the timing of our tests of operating effectiveness of controls, we consider:

- the period of time over which the tested controls will provide evidence;
- whether testing controls as of or through an interim date is effective, and if so, what additional procedures to perform over the remaining period of reliance; and
- whether we plan to use evidence about the effectiveness of automated controls (excluding GITCs) obtained in the prior period, and if so, whether that evidence provides sufficient appropriate audit evidence in the current period.

Not Integrated Audit | What is timing, and why do we consider it? [ISA | 608.1400]

The timing of an audit procedure refers to:

- when we obtain the evidence about the operating effectiveness of the control; and
- the period of time to which our audit procedure applies.

Are there implications of testing an automated control subsequent to period-end? [ISA | 608.12026]

Yes. When we are performing our testing for an automated control after period end, we obtain sufficient and appropriate audit evidence that demonstrates that the automated control was operating during the period of control reliance. This may include evidence that:

- the configuration of the automated control was in place prior to the period end; and
- the related GITCs continued to operate effectively throughout the period of reliance.

Is there a specific timing consideration for automated controls? [ISA | 608.7484]

If we test an automated control prior to period end, for example August 15, our procedures address the period of time from January 1 through August 15. In this scenario, the through date of the automated control is August 15. If the through date is prior to period-end, we perform rollforward procedures (see activity 'Determine additional evidence for the rollforward period, if applicable').

Are there specific timing considerations for manual controls? [ISA | 608.7485]

Yes. The period of time that is covered by our testing over manual controls is the date through which control instances were subject to selection. For example, if we select credit memo approvals from a

list from January 1 through September 30, the through date of our test is September 30, even if the last credit memo selected was dated September 15. The only time the through date can be the period-end balance sheet date is when we did the test on or after the balance sheet date and the year-end control instance was subject to selection.

How do we determine the period of reliance? [ISA | 608.1600]

We determine the period of reliance by considering:

- the period over which the control operated; and
- the period over which we want to rely on the controls.

The period of reliance is usually the entire period under audit. However, if a control was not designed to or did not operate during the entire audit period, the period of reliance may be less than the period under audit.

> For example, suppose:
>
> - an entity implements a new IT system partway through the period; or
> - management identifies a control deficiency and implements a new control during the period that is designed to remediate the deficiency on a prospective basis.
>
> In both cases, these controls are only in place for part of the period. If we intend to rely only on these new or modified controls, we only gather evidence about their operating effectiveness for the portion of the period they were in place.

Why do we consider the period of time our audit procedure applies to? [ISA | 608.12032]

We consider the period of time to which our audit procedures apply so that we:

- appropriately determine the period of our reliance; and
- obtain sufficient appropriate evidence to support our reliance on the operating effectiveness of controls during that period.

We often plan our control testing to gather evidence that the controls were operating throughout the entire period under audit (i.e. the period of reliance is the entire financial reporting period). If we only concentrate our control testing over a portion of the period, we would not obtain sufficient evidence that the control was operating throughout the entire financial reporting period and our period of reliance would be less than the full period.

The relevant time period for which we test a control depends on its nature and the financial statement account to which it relates. For example, it may be more important to obtain evidence of a control's effectiveness throughout the period for controls that operate over transactions that occur throughout the year, such as revenue transactions. Other controls may be more relevant or occur at certain points in the period - e.g. controls over year-end accruals.

> For example, suppose controls related to the pricing of revenue are not operating effectively in the early part of the financial reporting period. If management remediates the controls so that they operate effectively later in the year, the remediation doesn't address the risk of material misstatement (RMM) related to pricing of revenue transactions earlier in the year.

However, suppose a bank reconciliation control isn't performed early in the year but is effectively performed later in the year. The cumulative nature of the bank reconciliation control provides evidence over the cash balance as of the balance date over which the bank reconciliation is performed. However, we may not be able to rely on the reconciliation controls over the accuracy and completeness of data used in substantive analytical procedures.

How do we assess control risk and CAR when our period of reliance is less than the full audit period? [ISA | 608.1800]

When an RMM is addressed by a control or controls for which our period of reliance is less than the full audit period, we may have two different control risk assessments corresponding to the different portions of the audit period. This results in two different CAR assessments for the same RMM:

- one CAR for the period of reliance; and
- a second CAR for the remainder of the period subject to audit.

This situation is more likely to arise for significant accounts or disclosures and their assertions that relate to transactions that are recorded throughout the period.

Can we perform tests of controls at an interim period? [ISA | 608.2000]

Yes. In fact, we can often benefit from performing tests of controls for many controls before period end. When we perform our tests of operating effectiveness in an interim period, we obtain:

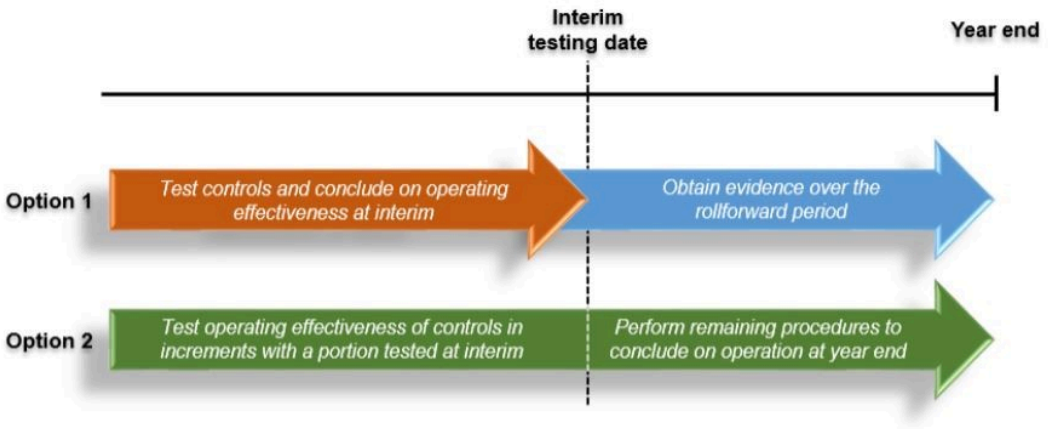
- earlier information that could affect our later audit procedures and conclusions;
- more persuasive evidence for our interim conclusion (if applicable) by testing controls closer to the time when they operated; and
- more time at the period end to perform those audit procedures that can only be performed at period end.

When we conclude at an interim period, we also perform rollforward procedures from the interim period to period end. These procedures allow us to obtain evidence that covers the period from our interim conclusion date through to the end of the period of reliance.

What are the approaches to testing controls at an interim date? [ISA | 608.12035]

We can approach testing controls at an interim date (i.e. before the end of the audit period) in two ways:

- test controls to reach a conclusion on operating effectiveness as of an interim date (Option 1); or
- test controls in increments at different points throughout the period of reliance - generally, the entire audit period (Option 2).



What do we consider when we test controls to reach a conclusion as of an interim date (Option 1)? [ISA | 608.12036]

When we perform Option 1, we perform our interim testing procedures and reach a conclusion on the control's operating effectiveness as of an interim date - i.e., we test the full sample size of control occurrences at interim testing and conclude on operating effectiveness at that time.

We then consider what additional evidence is necessary for the remaining period of reliance - i.e. the rollforward period - to allow us to extend our conclusion reached at interim to cover the full period of reliance. For further guidance, see activity in this chapter on 'Determine additional evidence for the rollforward period, if applicable'.

How do we test controls in increments throughout the year (Option 2)? [ISA | 608.12038]

When we perform Option 2, we perform our procedures to test the control in increments throughout the period and only reach a conclusion on operating effectiveness as of period end. Our testing covers the full period of reliance, so there is no rollforward period - i.e., we split our sample size of control occurrences into two or more increments and test them throughout the entire period of reliance. This allows us to conclude on operating effectiveness once, for the entire period.

Do we perform rollforward procedures for annual manual controls? [ISA | 608.7486]

No, as we test the single instance of the control and determine that the control is designed, implemented and operating effectively, we do not perform rollforward procedures unless we become aware that the control may have changed.

Can we test the operating effectiveness of a manual control as we evaluate its design and implementation? [ISA | 608.12057]

Yes. We may test the operating effectiveness of a control as we perform our procedures to evaluate its design and implementation.

Even though we perform these procedures together, each procedure has a different, specific objective. We therefore perform procedures that achieve our aims of testing the operating effectiveness of the control, gaining an understanding of it, and evaluating its design and implementation.

For example, some controls operate infrequently throughout the year - e.g. annual and quarterly controls. For these controls, we may perform procedures to help us understand them - i.e. perform a walkthrough - at the same time as we evaluate their design and implementation, and test their operating effectiveness.

How do we determine the correct sample size to use for a dual-purpose test? [ISA | 608.1500]

When we perform audit sampling, we determine the sample sizes for substantive tests (test of details) and tests of controls differently. When we perform a dual-purpose test, we determine the sample size necessary for the control test and substantive test separately. For example, if our sample size determine for control testing is 25 items, and our substantive testing size is 100 items, then we only apply our control testing procedures and substantive to 25 items and only the substantive procedures to the remaining 75 samples.

Examples

How does the timing of tests of controls relate to the period of reliance? [ISA | 608.2100]

Fact pattern

An engagement team tests a manual three-way match control that is performed on a recurring basis throughout the year (January 1 to December 31). The engagement team assesses the risk associated with the control (RAWTC) as Base. In September, the engagement team tests 25 instances of the control based on a selection of items from January through June.

Analysis

The procedures performed give the team evidence about the operation of the control from January through June (the period from which the sample was drawn), even though the testing was actually performed in September. Based on the procedures performed in September, the period from January to June is the period of reliance.

The engagement team has selected a sample that meets the minimum sample size guidance for a manual control that operates on a recurring basis with a RAWTC of Base. However, unless the engagement team performs additional procedures, their interim procedures do not provide evidence over the operation of the control for the remainder of the year (July to December).

How do we perform Options 1 and 2 when testing controls? [ISA | 608.2200]

Option 1: Concluding at interim

Fact pattern

The engagement team decides to test a manual control that occurs on a recurring basis with an assessed RAWTC of Base for a calendar year-end entity. The engagement team determines a sample size of 25 is appropriate for reperformance procedures.

The engagement team tests the control's effectiveness for the period from January to the end of August and performs interim procedures in September. The engagement team designs the interim test using the full sample of 25 control occurrences from throughout the interim period.

Analysis

The engagement team is able to conclude on the operating effectiveness of the control as of the end of the period from which they selected the samples - i.e. August 31.

The engagement team then determines what evidence is necessary during the rollforward period to extend their conclusion through year end. In this example, because of the Base RAWTC and the samples subject to the interim testing included those up till the end of August, which is four months before the fiscal year-end, inquiry alone may be an acceptable procedure in the remaining rollforward period. For further guidance, see activity in this chapter on 'Determine additional evidence for the rollforward period, if applicable'

Option 2: Concluding at period end

Fact pattern

Assume the same facts as in Option 1. However, the engagement team decides to prorate the 25 sample size between the interim period and the remaining period and thus test 16 occurrences of the control from January 1 to August 31, and an additional nine occurrences from September 1 to December 31.

Analysis

The engagement team chooses to test the control throughout the entire period of reliance, so no conclusion is reached until year end. Therefore, there is no rollforward period to consider.

3.1.4 Test superseded control activities when important to our control risk assessment [ISA | 1277]

What do we do?

IF the operating effectiveness of a superseded control activity is important to our control risk assessment, THEN we test the design, implementation, and operating effectiveness of the superseded control.

Why do we do this?

Management may make changes to controls to make them more effective or to address control deficiencies. We test both superseded control activities and the new control activity when they are both relevant to our control risk assessment.

Execute the Audit

What is a superseded control? [ISA | 1277.1300]

A superseded control is a control that existed at the entity that was replaced by a new or modified control.

What do we do when a control activity we planned to rely on is superseded? [ISA | 1277.1400]

We understand the reason for the change and evaluate whether that information might be indicative that the superseded control was not achieving its objective (i.e. PRP or RAFIT). For example, if a process control activity is superseded, we evaluate whether the original control was operating at a level that would detect or prevent a material misstatement.

Why would management supersede a control activity, and how might we respond? [ISA | 1277.1500]

Management may replace a control activity because the original control was not appropriately designed, not implemented, not operating effectively, not efficient, or because of other changes in the entity's control environment (e.g., implementation of a new IT system resulting in changes in the related control activities). Different reasons for superseding a control activity call for a different audit response:

Reason	Audit response
Deficient control	If a deficiency was identified, we determine the severity of the deficiency and the impact on our audit procedures.
Improve effectiveness of control	If the new control was implemented to be more effective, we determine whether the old control was operating at a level that would achieve its objective (e.g. be effective in preventing or detecting a material misstatement individually or in the aggregate or addressing the risk arising from IT). If not, it may represent a deficient control.
Improve efficiency	If the change was for efficiency or operational ease, we determine if it was a significant change as well as assess the period the new control operates over.
Other changes in the control environment	If a new control was implemented due to, for example, implementation of a new IT system, and we would like to place reliance on a superseded control for the period before the implementation, we obtain understanding of the superseded control to determine whether it was operating at a level that would achieve its objective (e.g. be effective in preventing or detecting a material misstatement individually or in the aggregate or addressing the risk arising from IT) and test the operating effectiveness of the superseded control when it is important to our control risk assessment for the period prior to the implementation.

What do we do if we want to place reliance on a superseded control? [ISA | 1277.159377]

If the operating effectiveness of a superseded control is important to our control risk assessment for the period during which the control was in place, we test the design, implementation, and operating effectiveness of the superseded control.

How do we determine the size of the sample to be selected when testing a superseded manual control? [ISA | 1277.1350]

In order to determine the size of the sample to be selected when testing a superseded manual control, we look at the "control sample size table" for manual controls (see question "What is the "control sample size table" for manual controls?") and may reduce the indicated control sample size by

applying the guidance for controls that operated for part of the year - see question 'When can we reduce the control sample size?'.

Do we evaluate the design and implementation of superseded controls in any other situations? [ISA | 1277.159378]

Yes. We evaluate the design and implementation of superseded control activities when they are relevant to our audit, even if we are not planning to rely on the controls (see question - "Which control activities do we understand and are relevant to the audit'?)

Examples

What is an example of a scenario in which we test superseded controls? [ISA | 1277.1450]

Fact Pattern

Entity R used IT System A to account for the sale of widgets. Effective July 1, 20XX, a new IT system (IT System B) was implemented to account for the sale of widgets. The change in the IT system resulted in a number of control activities being superseded by new controls. The engagement team relied on the superseded controls in connection with the prior year audit and found them to be appropriately designed, implemented and operating effectively at the time. Revenue from the sale of widgets is material to the overall financial statements and is comprised of a large volume of individually insignificant transactions. The engagement team plans to place reliance on controls for periods both before and after the implementation of the new IT system in order to reduce its substantive procedures.

Analysis

As the team plans to place reliance on superseded controls that operated in connection with IT System A through June 30, 20XX, the team first obtains understanding of the superseded controls to determine whether they were operating at a level that would achieve their objectives (e.g. be effective in preventing or detecting a material misstatement individually or in the aggregate or addressing the risk arising from IT). If the controls were appropriately designed and implemented, the team will test the operating effectiveness of the superseded controls to be able to adopt a controls reliance approach and reduce its substantive procedures over revenue from the sales of widgets for the six-month period through June 30, 20XX.

3.1.5 Determine the extent of procedures over controls [ISA | 1278]

What do we do?

Determine the extent of the tests of controls we will perform to provide evidence about the effectiveness of controls.

Why do we do this?

As we plan our procedures to test the operating effectiveness of controls, we consider the extent of evidence necessary to conclude. The greater the risk associated with the control, the greater the

evidence we obtain. One way we may obtain more evidence is by changing the extent of audit evidence obtained. If we do not obtain a sufficient amount of evidence we may incorrectly conclude that the control is operating effectively when it is not.

Execute the Audit

What does the 'extent' refer to when we test controls? [ISA | 1278.1300]

The extent of evidence refers to the quantity of evidence we obtain in our testing. This is often affected by the sample size or number of iterations of a control that we subject to audit procedures. The more extensively a control is tested, the more persuasive the evidence obtained from that test.

The extent of testing is particularly relevant when we are not testing all items in the population.

How do we determine the extent of testing necessary? [ISA | 1278.1400]

As the risk associated with the control (RAWTC) increases, we modify the nature, timing and extent of our procedures to obtain greater evidence. In modifying the extent, this means selecting more items for testing.

To determine the extent of evidence necessary to conclude on the operating effectiveness of a control, we:

(1) Define the population to be tested
(2) Determine the sample to be selected

What do we consider when designing the extent of our tests of controls? [ISA | 1278.1500]

When designing the extent of our tests of controls, we consider the following:

- Frequency of the performance of the control. The more frequently a control operates, the higher the extent of testing we perform.
- Risk Associated with the Control (RAWTC). As the risk associated with the control (RAWTC) increases, the higher the extent of testing we perform.

Frequency and RAWTC are factored into KPMG's control sample size table.

What is the 'control sample size table' for manual controls? [ISA | 1278.12157]

The 'control sample size table' represents the control sample size we use to test operating effectiveness of a manual control. It is based on:

- The frequency with which the control operates, and
- RAWTC (Significant+, Significant, Elevated or Base) we have assessed for a control

Frequency of the manual control	Control sample size			
	Significant + RAWTC	Significant RAWTC	Elevated RAWTC	Base RAWTC
Annual	1	1	1	1

Quarterly	1+1 (a)	1+1 (a)	1+1 (b)	1+1 (b)
Monthly	4	3	3	2
Weekly	11	9	7	5
Daily*	30	25	20	15
Recurring**	55	45	35	25

*Daily relates to a control that operates on a daily basis so it can be expected to operate between 250 - 366 times a year.

**For manual recurring controls, if we tested more than the indicated sample size and we meet the relevant criteria to accept some control deviations (see question 'What are the criteria to accept deviations when we increase the sample size for manual recurring controls?'), see question 'How many control deviations may we accept, when the sample size has been increased under the applicable guidance and we meet the relevant criteria to accept control deviations in our control sample?' for the relevant sample size table.

(a) One of the two quarters selected for testing is the fourth quarter instance of the control.

(b) When drawing a conclusion on the operating effectiveness at an interim date, any two quarters can be selected for testing. Procedures are performed to roll forward the conclusions reached at the interim date through the period of reliance or the 'as of' date (in an audit of internal control over financial reporting).

When testing the control for the full period of reliance through the period end or 'as of' date (e.g. all four instances of the control are available for testing at the time the test of effectiveness is performed), or when not drawing a conclusion on the operating effectiveness at an interim date, one of the two quarters selected for testing is the fourth quarter instance of the control.

How do we determine the frequency of a manual control for the purpose of determining the sample size?

[ISA | 1278.12158]

We determine the frequency of a manual control by considering its actual frequency and thinking about the number of times the control operation occurs (number of occurrences).

Where a periodic (not recurring) manual control has multiple occurrences, because it operates over parts of accounts/ transactions, we determine the sample size by considering the number of occurrences of the manual control.

For example, we are testing the operating effectiveness of monthly bank reconciliations performed on 100 bank accounts, where RAWTC is Base:

- Our control frequency is 12 months x 100 accounts = 1,200 occurrences in the period. The occurrence is akin to recurring per the table below.

- We consider this equivalent frequency and the RAWTC of Base and refer to the control sample size table to determine a sample size of 25.
- We select these 25 items from multiple points in the year and not just 1 month.

If the frequency or occurrence of a manual control sits between categories, we use the higher of the categories when determining our control sample size.

For example, we are testing the operating effectiveness of monthly bank reconciliations performed on 12 bank accounts, where RAWTC is Base:

- Our control frequency is 12 months x 12 accounts = 144 occurrences in the period. Therefore, occurrence is somewhere between weekly and daily.
- We refer to the table below and determine the equivalent frequency for this control to be daily. Based on the control sample size table, we select a sample of 15 items.

For example, if a manual control is performed twice a week and therefore occurs 104 times in the period, the frequency is somewhere between weekly and daily. We refer to the table below and determine the equivalent frequency to be daily. As the control's RAWTC is Base, we refer to the control sample size table and select a sample of 15 items.

Therefore, when a manual control, including an ad-hoc control, has a number of occurrences that it operates in the period we think about the following in determining the appropriate sample size:

Number of occurrences	Equates to the following frequency only when determining the sample size
1	Annual
2-4	Quarterly
5-12	Monthly
13-52	Weekly
53-366	Daily
>366	Recurring

How do we determine the frequency of a manual control for the purpose of determining the sample size where an entity uses an annual calendar structure with 13 periods or 53 weeks and has controls that operate each period or week? [ISA | 1278.158376]

When an entity uses a 13-period annual calendar (13 periods in a 12-month year) and has a control that operates each period (13 occurrences), we may treat the control as having a monthly control frequency despite it occurring more than 12 times. Similarly, when an entity has an annual period

that includes 53 weeks, we may treat a control that operates each week as having a weekly control frequency despite it occurring more than 52 times.

For example, a retail entity may divide an annual period into 13 periods shorter than calendar months. If RAWTC is Significant, our control sample size for the monthly periodic control (13 occurrences) is 3.

What are the criteria to accept deviations when we increase the sample size for manual recurring controls? [ISA | 1278.12160]

We may only accept deviations for manual recurring controls if we have increased the sample size from the 'control sample size table' and the following criteria are met:

- When we are performing a dual-purpose test and the substantive sample size is higher than the control sample size, and we use the larger of the sample sizes determined for controls and substantive procedures;

> For example, if we determined that a sample size of 100 items is appropriate for substantive testing and the determined control sample size is 25 items and we use 100 items as the sample size for both tests.

- When we are testing a control which operates across a number of homogeneous locations (see 'Allocate the control sample size');
- When we are using the work of internal audit and internal audit have tested a larger sample; or
- With concurrence from an accredited sampling professional.

Are there other circumstances in which we may increase the control sample size? [ISA | 1278.10000]

Yes. The 'control sample size table' represents the minimum control sample size we use to test operating effectiveness of a specific control. We can test more than the minimum sample size.

What is the population when we test controls? [ISA | 1278.1600]

We use our understanding of the control to determine the population - e.g. the set of transactions over which the control is intended to operate. For example, if a control operated over purchases greater than $5,000, we determine the population to be all purchase transactions exceeding $5,000. Selecting items less than $5,000 does not provide us evidence over the operating effectiveness of that control.

How do we determine whether the population is complete when we test controls? [ISA | 1278.1700]

In some cases, we may determine the completeness of the population by comparing the total population to the general ledger account.

> For example, suppose we are selecting individual invoices to inspect for authorization. We may agree the total of the invoices in the population to the balance of the expenses in the general ledger to confirm that our population is complete.

How do we assess completeness when we are unable to agree the population to the general ledger? [ISA | 1278.12077]

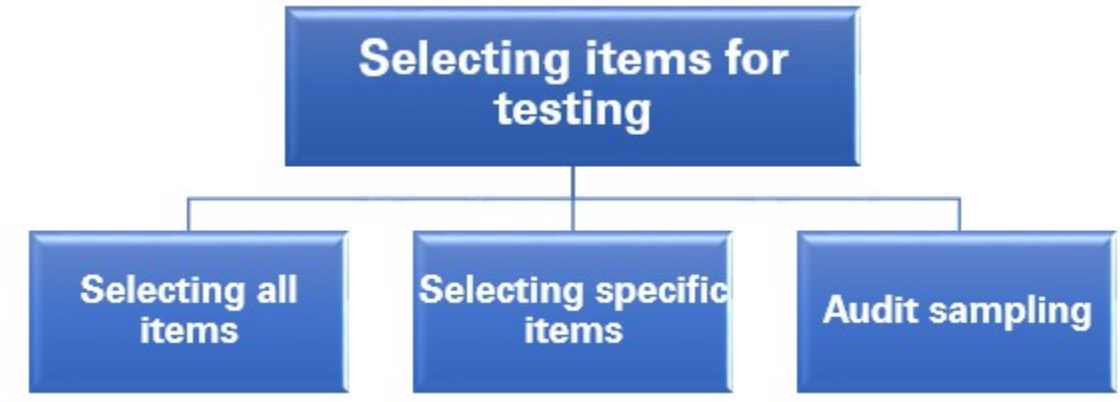
If we are not able to agree the total population to the general ledger, we perform different procedures to assess the completeness. The type of procedure we perform is unique to the situation. However,

we may be able to determine the completeness of a population by selecting items from a reciprocal population and agreeing them back to the population we are testing.

> For example, if management provides us with a listing of purchases greater than $5,000, we may start with the population of all purchases in the year and agree this to the general ledger, and then extract the population of all invoices greater than $5,000. If that is not possible, we may test the reliability of the entity report that contains the listing of all invoices over $5,000.

What options do we have for selecting items for testing manual controls? [ISA | 1278.1800]

We have three different ways we can select items for testing manual controls:



We may choose to use any one or a combination of these approaches depending on the particular circumstances of our planned procedures.

How do we decide which option for selecting items for testing to use? [ISA | 1278.1900]

Our decision about how we will select items is dependent on the nature of the procedure, characteristics of the control, and the evidence necessary to meet the objective of the procedure.

Audit Sampling:

When testing the operating effectiveness of controls, particularly manual controls, where the number of times we test the control's operation is important to drawing a conclusion about its effectiveness, we use audit sampling to select items for testing. Because manual controls are often designed to be performed in a consistent manner at regularly occurring intervals (i.e., daily, weekly, etc.), audit sampling allows us to evaluate the entire population by testing only a sample of the items during the period.

Refer to Audit Sampling (AS 2315, ISA 530, AU-C 530) for more information on performing audit sampling procedures to test the operating effectiveness of a control, including guidance over applicable sample sizes.

Selecting all items or specific items:

While use of a sampling approach is common when testing controls, there may be instances where selecting all items or selecting specific items is appropriate. For instance, if the population is comprised of very few occurrences during the period, we may select all items for testing.

How do we determine the extent of testing necessary for automated controls? [ISA | 1278.2000]

We may limit the extent of our testing of automated controls to one test of each attribute of the automated control. Because of the inherent consistency of IT processing, increasing the extent of our procedures to test an automated control may not provide more persuasive evidence in the same manner it does when testing a manual control. An automated control can be expected to function consistently unless the program - including the tables, files, or other permanent data used by the program - is changed or the control is otherwise overridden.

General IT Controls (GITCs) provide evidence that the automated control continues to operate effectively throughout the period, as long as we have:

- identified all the relevant risks arising from IT (RAFITs) that could affect the consistent operation of the automated control; and
- tested the operating effectiveness of GITCs that address them.

If we have not tested the operating effectiveness of the relevant GITCs or concluded that the relevant GITCs are not operating effectively throughout the period, there may be limited circumstances where we can test the operating effectiveness of the automated process control activities at multiple points in the period to gain evidence over the operating effectiveness throughout the period (see activity 'Test automated controls throughout the period, if appropriate' for further information). In this case, we are gaining evidence that identified RAFITs did not affect the consistent operation of the automated control, instead of relying on GITCs to address them.

What are relevant GITCs? [ISA | 1278.12080]

Relevant GITCs are those controls that address the relevant Risks Arising From IT (RAFITs) that affect the effective operation of the automated controls we are testing (i.e. those GITCs "linked" to RAFITs linked to the automated control).

What does it mean to test one of 'each attribute' for an automated control? [ISA | 1278.8961]

Testing one of 'each attribute' does not mean we test only one instance of the operation of the automated control. Rather, it means we may limit the extent of our testing of some automated controls to one test of each attribute of the automated control. The attributes of an automated control are the specific functions or steps performed by the IT system.

When testing an automated control, we first understand the design of the automated control and each attribute of the control. Then for each attribute we identify the scenarios related to each attribute and test each scenario that addresses the identified PRPs/RAFITs. We do this because each scenario may use different tables, files, data, or system logic depending on the business process.

Even an automated control that involves a simple configuration may have more than one scenario. For example, an automated control is in place that sends all invoices greater than $5,000 for approval. All invoices equal to or less than $5,000 are not sent for approval. In this example, there are two scenarios: (1) an invoice of less than 5,000 is not sent for approval and (2) an invoice of more than $5,000 is sent for approval. Both scenarios are tested for design and implementation and operating effectiveness.

Do we test every scenario when we test an automated control? [ISA | 1278.8962]

No, we test each scenario of an automated control that is responsive to an identified PRP/RAFIT. We focus on the identification and understanding of control attributes and scenarios that address a relevant PRP/RAFIT. We test the control attributes and scenarios that are responding to the

identified PRPs/RAFITs. If a scenario processed by the automated control is not responsive to an identified PRP/RAFIT, we do not test that scenario. In this situation, we think about documenting our rationale for not testing a particular scenario if it is necessary to support our risk assessment and audit response.

For example, there are six depreciation methods being used by the Company. We did not identify a PRP associated with the calculation of depreciation expense for the five other depreciation methods because the amounts recorded using these depreciation methods result in a remote risk of material misstatement. Therefore, we do not test the five other depreciation methods as part of our automated control testing. We consider obtaining evidence and documenting our risk assessment for not testing the scenarios of the automated control associated with the five other depreciation methods used by the Company if we believe it is necessary to support our risk assessment.

What do we do if the IT systems that the automated controls rely on change and we are testing each attribute of the automated control once? [ISA | 1278.12081]

When changes are made to an IT system that impact the automated controls we are relying on, we think about whether additional procedures are necessary to test the control after the changes occur, especially when the changes may impact the design and/or operating effectiveness of automated controls. When we have tested each attribute once, it may be necessary to perform our testing again after the date of the change. Failing to consider changes in IT systems or the impact relevant GITCs have on an automated control can result in us not gathering sufficient evidence about the operating effectiveness of an automated control for the entire period of reliance.

Examples

What is an example of testing operating effectiveness of an automated control? [ISA | 1278.2100]

Fact pattern

As part of the engagement team's control testing, they identify a relevant automated control over the authorization over all accounts payable transactions. The control is intended to:

- auto-approve transactions below $10,000
- place a hold on transactions in excess of $10,000 that restricts payment until the Controller approves the transaction in the IT system.

The team has tested the relevant GITCs associated with this automated control and found them to be operating effectively.

Analysis

The procedures to test the operating effectiveness of this control may include inspecting evidence from the IT system that parameters within the IT system are configured to i) identify transactions up to $10,000 as approved for payment and ii) place a hold on transactions over $10,000 until the Controller approves in the IT system. Because GITCs have been found to be operating effectively, the team concludes that the system will treat each transaction according to the configuration consistently.

What is an example of testing the operating effectiveness of one of 'each attribute' of an automated control? [ISA | 1278.8963]

Fact Pattern 1

Entity A has a process around approving customer orders based on existing credit limits. Entity A identified an automated control over the approval of customer orders.

Analysis 1

Control	Attributes	Scenarios
The system is configured to process orders for active customers within their credit limit (less outstanding AR + pending orders).	Based on the existing credit limit for active customers, for orders exceeding the active customer's credit (less outstanding AR + pending orders), the system will deny and prevent processing of the order.	• If the order is for an active customer, and the order does not exceed the active customer's credit (less outstanding AR + pending orders), the system will process the order. • If the order is for an active customer, and the order exceeds the active customer's credit (less outstanding AR + pending orders), the system will deny an order from being processed. • If the order is for an inactive customer, the system will not allow an order to be processed.

Fact Pattern 2

Entity A utilizes depreciation methods to calculate depreciation expense. Entity A uses two depreciation methods: straight-line and declining balance to calculate depreciation expense based on the configuration in the system. Entity A identified an automated control over the systematic calculation of depreciation expense.

Analysis 2

Control	Attributes	Scenarios
The system is configured to automatically calculate depreciation expense based on the depreciation flag.	Based on the depreciation flag and the depreciation rate set for the asset, the system calculates depreciation for the period.	• If the asset is flagged for straight line, the system calculates straight line depreciation. • If the asset is flagged for declining balance,

		the system calculates declining balance depreciation. • If the asset is not flagged for any method no depreciation is calculated.

3.1.5.1 Test automated process control activities throughout the period, if appropriate [ISA | 7612]

What do we do?

IF circumstances are appropriate THEN we may test the operating effectiveness of an automated process control activity at multiple points throughout the period

Why do we do this?

In certain circumstances and when we do not rely on relevant general IT controls (GITCs), we may test the automated process control activity at multiple points throughout the period to gain evidence that the Risk Arising from IT (RAFIT) has not affected the operating effectiveness of that control to enable us to continue to rely on that control.

Execute the audit

When may we test the operating effectiveness of automated process control activities at multiple points throughout the period? [ISA | 7612.12097]

We may test the operating effectiveness of automated process control activities at multiple points throughout the period when:

- we have not tested the operating effectiveness of the relevant GITCs; or
- where we have concluded that a relevant GITC is not operating effectively throughout the period under audit. However, this approach is only appropriate in limited circumstances.

Enhanced | When is it inappropriate to test automated process control activities at multiple points throughout the period? [ISA | 7612.12098]

We use our judgment when assessing whether it is appropriate to test automated process control activities throughout the period considering certain factors. The following table indicates circumstances when it is inappropriate to test an automated process control activity at multiple points throughout the period:

Factor	Circumstance indicates that the approach is inappropriate

Complexity of the IT environment	A complex IT environment or indications from our understanding of CERAMIC that the IT environment is inappropriately designed
Assessment of inherent risk for the risks of material misstatement (RMMs), especially fraud risks	The automated process control activity is intended to respond to a significant risk
Nature and frequency of the control	The automated process control activity is more complex or the frequency of operation of the automated process control activity is so high that our length of intervals for testing becomes very small
Frequency of changes to the relevant IT layers	Frequent changes to the relevant IT layers
Risk associated with the control (RAWTC)	RAWTC is assessed as significant or significant +
Significant deficiency in GITC	We identify a significant deficiency in a GITC related to the automated process control activity

When we apply this approach, we seek advice from an appropriate individual with expertise in IT as they may identify technical limitations that would undermine the testing using this approach.

Core and Less Complex | When is it inappropriate to test automated process control activities at multiple points throughout the period? [ISA | 7612.12099]

We use our judgment when assessing whether it is appropriate to test automated process control activities throughout the period considering certain factors. The following table indicates circumstances when it is inappropriate to test an automated process control activity at multiple points throughout the period:

Factor	**Circumstance indicates that the approach is inappropriate**
Complexity of the IT environment	A complex IT environment or indications from our understanding of CERAMIC that the IT environment is inappropriately designed

Assessment of inherent risk for the risks of material misstatement (RMMs), especially fraud risks	The automated process control activity is intended to respond to a significant risk
Nature and frequency of the control	The automated process control activity is more complex or the frequency of operation of the automated process control activity is so high that our length of intervals for testing becomes very small
Frequency of changes to the relevant IT layers	Frequent changes to the relevant IT layers
Risk associated with the control (RAWTC) for the automated process control activity	RAWTC is assessed as significant or significant +
Significant deficiency in GITC	We identify a significant deficiency in a GITC related to the automated process control activity

In the first year that we test an automated process control activity throughout the period, we seek advice from an appropriate individual with expertise in IT as they may identify technical limitations that would undermine the testing using this approach. An appropriate individual with expertise in IT is also involved in a subsequent audit when there is a change in IT systems or IT personnel that impacts the operation of that automated process control activity.

How do we assess whether to use this approach? [ISA | 7612.6221]

We separately assess whether it is appropriate to use this approach and how to apply this approach, including seeking the advice of an appropriate individual with expertise in IT, for each automated process control activity that the approach may be relevant to. We cannot determine to take this approach at a layer, process or higher level.

What factors do we consider when determining the length of an interval when testing an automated process control activity at multiple points throughout the period? [ISA | 7612.12100]

The following table indicates the factors we consider and how they affect the length of the interval used when testing an automated process control activity at multiple points throughout the period:

Factor	Impact
Complexity of the IT environment	The more complex the IT environment the shorter the intervals between controls.

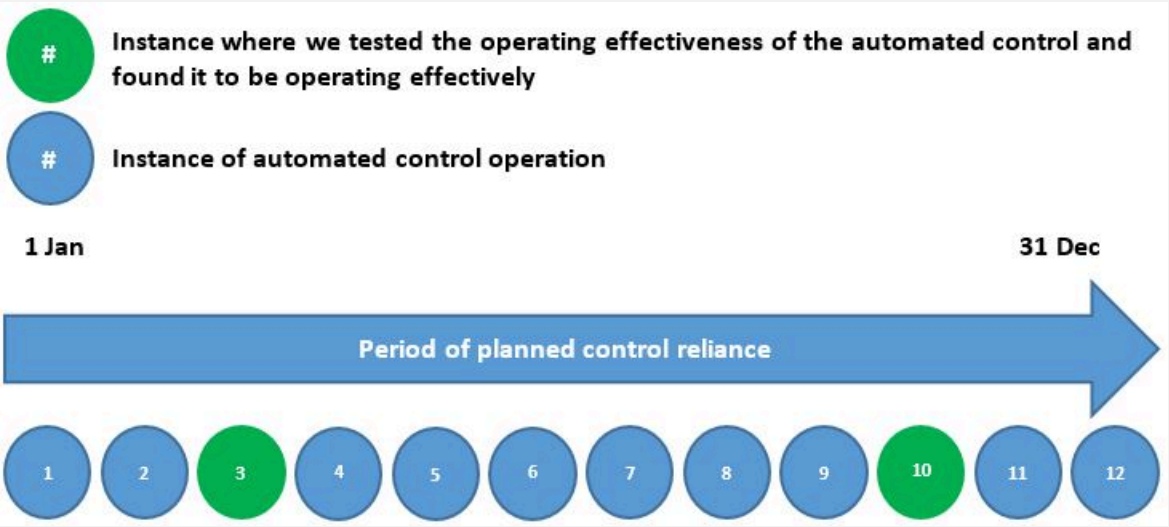
Assessment of inherent risk for the RMMs, especially inherent risk of fraud	The higher the assessment of inherent risk the shorter the interval between controls.
Nature of the control	The more complex the automated process control activity, the shorter the intervals between controls.
Frequency of changes to the IT layers	The more frequently that there are changes to the relevant IT layers, the shorter the intervals
RAWTC	The higher the assessed RAWTC for the automated process control activity the shorter the intervals

The shortness of the intervals combined with the frequency of the control determines the number of times in the period we test the automated process control activity. For a recurring automated process control activity that operates separately over each individual transaction, the control operates multiple times per day, such that even long intervals may result in testing at a large number of points in the period. On the other hand for an automated process control activity that operates once a month, even a short interval may result in testing at a few points in the period.

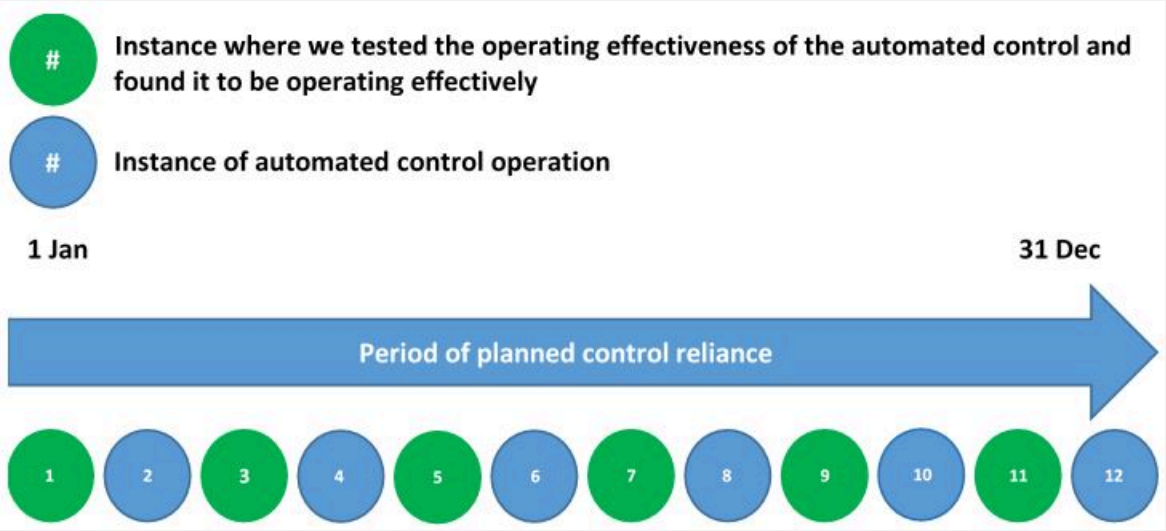
Why do we consider these factors to determine how frequently to test an automated process control activity at multiple points throughout the period? [ISA | 7612.12102]

We consider these factors to determine how frequently to test an automated process control activity at multiple points throughout the period because they are helpful in selecting the appropriate number of instances to test in order to obtain sufficient evidence over the consistent operation of the control.

For example, we have determined that it is appropriate to test a monthly automated process control activity at multiple points throughout the period based on our consideration of the relevant factors. We are testing the control within a non-complex IT environment, with no changes to IT layers. We determine to test 2 instances of the control.



However, if the IT environment is more complex and there are more frequent changes to IT layers, providing we have determined that this approach remains appropriate, our testing intervals become shorter and we test the automated process control activity more frequently.



Do we use the control sample size table to determine points in the period to test the automated process control activity? [ISA | 7612.12103]

No, we do not use the control sample size table for testing manual controls to determine points in the period to test the automated process control activity. These sample sizes are appropriate for manual controls only (see activity 'Determine the control sample size').

Instead we determine the number of instances to test through professional judgement factoring in the considerations in accordance with 'What factors do we consider when determining the length of an interval when testing an automated process control activity at multiple points throughout the period?' and combine that with the frequency of operation to determine the number of points in the period to test.

3.2 Obtain evidence about the operating effectiveness of controls [ISA | 1279]

What do we do?

Obtain audit evidence about the operating effectiveness of the controls, including how the controls were applied at relevant times, the consistency with which they were applied, and by whom or what means they were applied.

Why do we do this?

When we test the operating effectiveness of a controls, we obtain evidence to support the controls' operation. This includes obtaining evidence to support:

- how the controls were applied during the year;
- how consistently they were applied; and
- who or by what means the control was applied.

These aspects of the control's operation help us evaluate whether the control was performed consistently and effectively throughout the period.

Execute the Audit

What evidence do we obtain about the operating effectiveness of controls? [ISA | 1279.1300]

We perform inquiries and other audit procedures to directly test and obtain evidence about the operating effectiveness of a control, including evidence about:

- how the control was applied at relevant times during the period under audit;
- the consistency with which it was applied; and
- who or by what means the control was applied

How do we obtain evidence about how the control was applied at relevant times? [ISA | 1279.1400]

When we obtain evidence about how the control was applied at relevant times during the period under audit, we:

- obtain a complete population of the items over which the control should have been applied or performed;
- select an appropriate number of these items to test; and
- assess whether the control operated as designed and in a timely manner over each selected item.

Why do we consider whether a control was performed in a timely manner? [ISA | 1279.12111]

We consider whether a control was performed in a timely manner because a material misstatement could exist until the control is performed. If the period of time between when a control is expected to be performed and when it is actually performed spans reporting periods, the control's lack of timely operation may fail to prevent and/or detect a material misstatement to the financial statements.

When we obtain evidence that a control did not operate when it was designed to or in a timely manner, we conclude that the control is not operating effectively and we do not rely on it.

How do we obtain evidence about whether the control was consistently applied? [ISA | 1279.1500]

When we obtain evidence about whether a control was consistently applied, we:

- select items from a complete population of transactions or instances when the control is expected to have been applied or performed; and
- determine whether the control operated as designed for each of those instances.

How do we obtain evidence about who or by what means the control was applied? [ISA | 1279.1600]

We obtain evidence about who or by what means a control was applied through various procedures, including inquiry, observation, inspection or reperformance.

> For example, we may inquire of management and learn that the accounting manager performs the quarterly review of bank reconciliations. We may obtain evidence about who - i.e. the accounting manager - and by what means - i.e. quarterly manual review - the bank reconciliation review is applied by inquiring of the accounting manager and inspecting a bank reconciliation to evidence their review.

A control can be manual or automated.

- **Manual controls** are applied by people.
- **Automated controls** are applied by IT systems.

How do we obtain evidence about the operation of an automated control? [ISA | 1279.8432]

When we obtain evidence about the implementation/operation of an automated control, we obtain evidence about whether the control was performed by the IT systems in a manner that is consistent with its design.

We may obtain evidence about an automated control's continued operation throughout the period by testing GITCs.

How do we obtain evidence about who or by what means a manual control was applied? [ISA | 1279.12116]

For manual controls, we obtain evidence that the control operator(s), having both the authority and competence to perform the control effectively, has performed the control in a manner that is consistent with its design for those control(s) selected for testing.

We assess whether the control operator(s) has the right level of authority and competence as part of evaluating the design of the control. Refer to activity 'Understand the authority and competence of the control operator' in the risk assessment chapter for guidance on assessing the authority and competence of the control operator.

What do we document when we test the operating effectiveness of controls? [ISA | 1279.1700]

We document:

- a description of the nature, timing and extent of our tests of operating effectiveness;
- the linkage of those procedures with the RMM; and

- the results of our tests of operating effectiveness, including the conclusions where these are not otherwise clear.

How do we test the operating effectiveness of control activities that involve judgment? [ISA | 1279.1800]

We test the operating effectiveness of a control activity that involves judgment in the same way as we test any other control, except, for each instance of the control we test, we also:

- evaluate the steps performed by the control operator to identify and investigate outliers, including whether outliers were appropriately identified; and
- evaluate the conclusions reached in the control operator's investigation, including whether all outliers were appropriately investigated and whether corrective actions were taken as needed.

Because the control operator uses judgment, we obtain more persuasive evidence than we do for other controls involving no judgment, especially as it relates to understanding any judgmental criteria applied by the control operator for identifying and investigating outliers.

We also pay attention to the consistent application of judgmental criteria, where applicable, through the evaluation and tests of implementation and operating effectiveness.

Is an outlier a misstatement? [ISA | 1279.12091]

Not always. Outliers do not necessarily lead to misstatements. Rather, it triggers the control operator to further investigate in order to:

- confirm the appropriateness of the outlier;
- identify whether or not the outlier:
  - is an error that needs correction; or
  - otherwise indicates that the related account balance contains an error; and
- determine whether further information or activities are needed to resolve the matter.

If we identify the same outliers, can we conclude the control activity that involves judgment is operating effectively? [ISA | 1279.12119]

No. Even if we use reperformance and identify the same outliers as the control operator, we can't conclude that the control activity is operating effectively until we:

- determine whether the conclusions reached in the control operator's investigation were appropriate; and
- evaluate how the control operator investigated and resolved the outliers, including whether:
  - outliers were appropriately investigated; and
  - corrective actions were taken as needed.

Like any other detective control, we also test the entity's process to resolve any outliers.

What do we do when we do not identify any outliers when reperforming a control activity that involves judgment? [ISA | 1279.12120]

In evaluating the design and implementation and testing of operating effectiveness over control activities that involve judgment, the engagement team may still conclude that the control is designed, implemented and operating effectively when the control does not identify any outliers. An engagement team may conclude that:

- the control activity is:
  - designed effectively with a sufficient precision to prevent, or detect and correct, a material misstatement in a timely manner over the financial statement assertions it is intended to address (process control activities); or
  - designed effectively to address the relevant RAFIT (GITCs), and
- control operator has performed the control as designed and identifying no outliers is appropriate based on the control activity's design.

Keep in mind that the criteria for investigation used by the control operator to identify outliers is an important element of the control's design, especially when the control activity involves judgment. Evaluating whether the criteria are sufficient to achieve the control's objective requires careful evaluation.

What do we consider when the control activity that involves judgment identifies a large number of outliers? [ISA | 1279.12121]

When we reperform a control activity that involves judgment and identify a large number of outliers, we may consider whether other controls are missing or deficient, putting pressure on the control activity involving judgment and affecting its ability to operate effectively.

Examples

How many outliers represent sufficient evidence of operating effectiveness? [ISA | 1279.1900]

Fact pattern

Management has a significant securities investment portfolio consisting primarily of Level 1 and Level 2 securities. Management performs a review control related to the valuation of investment securities. As part of the control attributes, management investigates any prices provided by two independent third-party service providers that vary by 2 percent - i.e. the criteria for investigation is to review any variance greater than 2 percent and an outlier is any variance outside of that threshold. Based on the average historical values of the securities, a 2 percent variance is not individually material but could become material based on the aggregation of 2 percent variances of 5-10 individual securities.

Analysis

The engagement team considers several items. For example, what does history indicate is a normal variation between the prices of the two service providers?

- For Level 1 securities, there are likely no differences, so the 2 percent threshold is not likely to produce any outliers. Given the relatively high threshold compared to the expectation, this indicates that the threshold is not appropriate for Level 1 securities. However, when considering the 2 percent variance in relation to materiality, and the fact that no differences are expected, the threshold may be appropriate.
- For Level 2 securities, the third-party service providers' valuations may vary considerably by type of instrument. For some types of securities, many outliers would exceed the 2 percent threshold. For other types of securities, none would exceed the 2 percent threshold. This indicates that a 2 percent threshold is not appropriate for all types of securities.

The appropriateness of thresholds and the numbers of outliers they identify may also change over time because of changes in external and interior factors. The 2 percent threshold may appear high

and identify no outliers for certain highly liquid securities at a time when securities are stable and predictable. However, when the market is uncertain, the same 2 percent threshold may become too narrow. It may therefore lead us to identify a greater number of outliers than is expected considering the uncertainty inherent in securities valuation.

There is no specified way to determine whether the number of outliers provides sufficient evidence or indicates that the threshold is appropriate. The determination may depend on careful evaluation of the design of the metrics, thresholds and other criteria used in the execution of the control, as well as the resolution of the identified outliers:

- If the prices from both third-party pricing services are the same for all Level 1 securities, there are no outliers. This does not mean that the control is ineffective because little to no difference is expected in the estimated prices.
- If only two outliers relate to a particular type of security classified as Level 2, that may or may not provide sufficient evidence.
    - If both outliers are investigated, an adjustment is needed, and there are several similar securities with price variations just below the threshold used to identify outliers, the threshold may need to be adjusted downward.
    - If neither outlier results in an adjustment and the remaining similar securities do not have variances close to the threshold, two outliers may be sufficient.

For situations between these two examples, judgment is used to determine whether the control is operating at a sufficient level of precision to detect or prevent a material misstatement.

Using audit evidence obtained during an interim period

International Standards on Auditing: ISA 330.12

Using audit evidence obtained during an interim period

12. If the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor shall:

(a) Obtain audit evidence about significant changes to those controls subsequent to the interim period; and

(b) Determine the additional audit evidence to be obtained for the remaining period. (Ref: Para. A34-A35)

ISA Application and Other Explanatory Material: ISA 330.A34-A35

Using audit evidence obtained during an interim period (Ref: Para. 12(b))

A34. Relevant factors in determining what additional audit evidence to obtain about controls that were operating during the period remaining after an interim period, include:

- The significance of the assessed risks of material misstatement at the assertion level.

- The specific controls that were tested during the interim period, and significant changes to them since they were tested, including changes in the information system, processes, and personnel.
- The degree to which audit evidence about the operating effectiveness of those controls was obtained.
- The length of the remaining period.
- The extent to which the auditor intends to reduce further substantive procedures based on the reliance of controls.
- The control environment.

A35. Additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the entity's monitoring of controls.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Determine additional evidence for the rollforward period, if applicable [ISA | 610]

What do we do?

IF we conclude on the operating effectiveness of a control as of or through an interim date, THEN determine the additional audit evidence to be obtained for the remaining period

Why do we do this?

When we obtain audit evidence about the operating effectiveness of controls as of or through an interim date, we also obtain persuasive evidence about their operating effectiveness for the rollforward period - i.e. for the period from the interim date to the end of the period. This allows us to extend our conclusions from an interim period over the remaining period.

Execute the Audit

What is the rollforward period of a control conclusion when we perform a financial statement audit? [ISA | 610.1300]

When we perform a financial statement audit, the rollforward period is the period from the date of our interim conclusion on the operating effectiveness of the control to the end of the period of reliance (usually the period-end date of the financial statements). In other words, the rollforward period is the gap between the period covered by our interim testing and the full period of reliance.

What procedures do we perform to rollforward our interim conclusions on the operating effectiveness of controls? [ISA | 610.1600]

To extend our conclusions forward from interim to the end of the rollforward period, we:

- inquire of control operators to determine whether any significant changes occurred since the interim period;
- evaluate whether factors suggest we need more evidence to roll forward our interim conclusion; and

- perform additional audit procedures to obtain sufficient appropriate audit evidence as necessary.

How are the rollforward procedures for automated process control activities different than those for manual controls? [ISA | 610.1700]

The rollforward considerations for automated process control activities, including benchmarked automated process control activities, differ from manual controls. Because IT processing is inherently consistent, we may determine that evidence from inquiries is sufficient to conclude on the operating effectiveness of those automated process control activities even when the rollforward period is greater than four months when:

- the design of the automated process control activity has not significantly changed since we concluded at an interim date that the automated process control activity was effective (see activity 'Inquire to identify changes in controls during the rollforward period'); and
- the related general IT controls are effective during the entire period (including the rollforward period).

Core and Less Complex | Do we perform rollforward procedures when using prior period audit evidence for testing manual controls? [ISA | 610.7483]

When our procedures to evaluate the appropriateness of using prior period audit evidence (e.g. walkthrough of the business process' and/or evaluation of design and implementation of the control) are performed prior to period end, then we perform rollforward procedures. We may determine that evidence from inquiries is sufficient to continue to rely on prior period evidence even when the rollforward period is greater than four months provided that the design and implementation of the control has not changed significantly.

1.1 Inquire to identify changes in controls during the rollforward period [ISA | 611]

What do we do?

IF we conclude on the operating effectiveness of a control as of or through an interim date, THEN inquire to identify changes to controls during the rollforward period

Why do we do this?

When we test controls as of or through an interim date, we perform inquiries to help us:

- obtain evidence about the operation of the control during the rollforward period; and
- identify whether a change in the control has occurred.

If we fail to identify that a control has changed since we performed our interim testing and we rollforward our interim conclusion, we may not perform sufficient appropriate procedures over the operation of controls during the rollforward period. Therefore, we inquire as part of our rollforward procedures.

Execute the Audit

Who do we inquire of to rollforward our interim conclusions on the operating effectiveness of controls? [ISA | 611.1300]

We inquire of the specific control operators responsible for the operation of the control itself.

What do we inquire of the specific control operators about to rollforward our interim conclusions on the operating effectiveness of controls? [ISA | 611.1500]

We inquire of the specific control operators regarding whether there have been any changes in the design or operation of the control itself since we concluded on its operating effectiveness as of or through an interim date. These inquiries may help to identify:

- new or significant modifications to IT systems;
- significant modifications to existing processes, including process reengineering;
- how process owners monitor any control changes;
- potential breakdowns in the control;
- significant new positions or changes in job roles or responsibilities, including employee turnover;
- new and evolving industry and/or entity-specific risks;
- changes in accounting policies or principles, or in financial reporting requirements;
- indicators of fraudulent activity or errors;
- changes in the regulatory environment; and
- potential for management override of the controls.

1.2 Determine what additional evidence is necessary [ISA | 1282]

What do we do?

IF we conclude on the operating effectiveness of a control activity as of or through an interim date, THEN evaluate relevant factors to determine what additional evidence is necessary to rollforward our interim conclusions.

Why do we do this?

When we obtain audit evidence about the operating effectiveness of control activities during an interim period, we also obtain evidence about their operating effectiveness for the rollforward period - i.e. for the remaining period of reliance. Doing this allows us to extend our conclusions from an interim period over the remaining period.

We consider various factors to help us determine the audit evidence necessary - for example, the length of the rollforward period.

If we do not obtain sufficient, appropriate audit evidence to rollforward our interim conclusion, we would not have sufficient evidence to support control risk at less than the maximum.

Execute the Audit

What relevant factors do we consider to determine the nature and extent of evidence to obtain in order to rollforward our conclusions from an interim date? [ISA | 1282.1300]

When determining the additional evidence necessary, we consider the following relevant factors:

- the inherent risk associated with the risks of material misstatement (RMMs);
- the risk associated with the control (RAWTC);
- the nature of the control and the related risk that the control is no longer effective after our interim procedures;
- the sufficiency of evidence of effectiveness obtained at an interim date;
- the results of the tests of the control at the interim date;
- the planned degree of reliance on the control;
- the length of the rollforward period; and
- the possibility that there were significant changes in ICFR after the interim date.

As with other audit procedures, our evaluation of these factors may lead us increase or decrease the persuasiveness of our audit evidence by modifying the nature and extent of our procedures. There are no bright-lines about what type or how much evidence is necessary to rollforward our interim conclusions to the end of the rollforward period (i.e. the nature and extent).

When is inquiry alone not sufficient evidence to conclude on the rollforward period? [ISA | 1282.1400]

When rolling forward our conclusions on controls, we do not use inquiry alone to rollforward our conclusions reached at or through an interim date when:

(a) For manual process control activities:
- the rollforward period is longer than four months; or
- there have been significant changes in the design of the control since the interim date; or
- control addresses an RMM where substantive procedures alone would not be sufficient.

(b) For automated process control activities:
- there have been significant changes in the design of the process control activity since the interim date.

(c) For GITCs (both manual and automated):
- the rollforward period is longer than four months; or
- there have been significant changes in the design of the control since the interim date.

How do the relevant factors we consider affect the nature and extent of evidence to obtain in order to rollforward our conclusions from an interim date? [ISA | 1282.1500]

The table below outlines how the factors we consider could indicate that we may need more or less persuasive audit evidence to rollforward our conclusions from an interim date:

Factor	Indicators that we may need more persuasive evidence - i.e. more than inquiry alone	Indicators that we may need less persuasive evidence
RAWTC	Controls with RAWTC assessed as Elevated or above	Controls with RAWTC assessed as Base

Specific control tested before period end, including the nature of the control	Control activities that involve significant judgment, may be more prone to human error, or are likely to have changed during the rollforward period - e.g. a control related to review of an estimate that involves significant judgment by the control operator	Controls that are more routine, have a reduced susceptibility to human error - e.g. automated controls - or not likely to change - e.g. a recurring manual control with no past history of deficiencies or significant changes
The results of the tests of the control at the interim date	Deficiencies identified in the control or misstatements in the related significant account in prior periods	An automated control in a stable IT environment where relevant general IT controls have been tested and found to be operating effectively for the full period of reliance
The sufficiency of evidence obtained at the interim date *Note - If conditions indicate that audit evidence to be obtained is not relevant, not reliable or both, then that audit evidence is not sufficient to conclude on the operating effectiveness of the control*	Audit evidence about the control's operating effectiveness that is less relevant or reliable	Audit evidence about the control's operating effectiveness that is more relevant and reliable
Planned degree of reliance on the control, including when substantive procedures alone cannot provide sufficient appropriate audit evidence	A control that is required to be tested because substantive procedures alone will not provide sufficient appropriate audit evidence	A control that is not required to be tested
Length of remaining - i.e. rollforward - period	Longer rollforward period - e.g. five months	Shorter rollforward period - e.g. one month
Possibility of significant changes in internal control	Higher probability of significant changes in internal control - e.g.	Lower probability of significant changes in internal control - a control

over financial reporting after the interim date	changes in key personnel or management that perform the control or monitor its performance	that has operated for many periods without changes and has had no changes in key personnel or management who perform the control or monitor its performance.

What is a significant change in a control? [ISA | 1282.12131]

A significant change in a control is a change in a control's design that essentially makes it a new control when we compare it to the control we evaluated at an interim period. Determining whether the design of a control has changed is a matter of auditor judgment.

The design of a control may change when the following elements of the control change:

- the control objective;
- the nature of the control - e.g. from automated to manual control;
- the frequency of a control's operation;
- when a control is performed;
- who operates the control - e.g. for a control involving judgment;
- the reports or information used in performing the control;
- remediate a deficiency identified during the year;
- how a control activity that involves judgment is performed - e.g. changes to the methodology, inputs or assumptions in an accounting estimate that affect how a control operator reviews those items; and
- upgrade to an application or IT system change that alters how the automated control functions.

Do we always consider a change in the control operator to be a change in the control's design? [ISA | 1282.12132]

No. Not all changes in the control operator are changes in the design of the control. When we evaluate the design of a control, we evaluate whether the control operator(s) has the necessary authority and competence to perform the control effectively. Changes among control operators who all have the necessary competence and authority are not significant changes - e.g. various authorized warehouse personnel performing cycle count controls.

By contrast, a change in the control operators from operators at the warehouse to operators at the head office or vice versa is more likely to be viewed as a significant change. This change also affects how the control is performed.

When a control requires more than minimal amounts of judgment, we may also consider a change in the control operator to be a significant change.

How do we identify when a change in the design of a control has occurred? [ISA | 1282.12139]

To identify whether a change in the control's design has occurred, we:

- inquire of control operators;
- perform other rollforward procedures for a control beyond inquiry (if applicable);
- evaluate the results of our substantive procedures; and
- consider our ongoing risk assessment procedures.

What if the design of a control changes during the rollforward period? [ISA | 1282.12140]

When we identify changes in the design of controls during the rollforward period, we understand why the change occurred and treat the changed control as a new or modified control.

Depending on the reasons, we may:

- determine that our interim conclusion on the design or operating effectiveness was not appropriate - i.e. the entity found that the control was not designed appropriately based on changes in the business;
- test the design and operating effectiveness of the new or modified control for the remainder of the period if we plan to rely on it; or
- do not test the design and operating effectiveness of the new or modified control if we do not intend to place reliance on it.

Our assessment of control risk is for the period of reliance. If we evaluate and test a control for part of the period but not the remaining period, we would have a different control risk for those periods.

> For example, we might have two different control risks if we reached an interim conclusion for a control that was performed at the corporate level but through our rollforward procedures we identify a significant change in the design of the control on July 1st, where the company moves the operation of a control to the warehouse. We decide not to test the control after July 1st. We then bifurcate our control risk to the January 1 - June 30 period as "controls reliance" (assuming no issues were identified with the old control based on our understanding of the significant change) and our control risk for July 1 - December 31 as Controls no reliance.

When might we do more than just inquiry alone to conclude on the rollforward period? [ISA | 1282.1700]

When rolling forward our conclusions on manual controls, we usually expect the nature of the roll-forward to be more extensive than inquiry alone and the roll-forward period to be shorter when the RAWTC is assessed as Elevated or above. Even if the rollforward period is less than four months, there may be situations where inquiry alone may not provide sufficient evidence about the operation of a control during the rollforward period. This depends on our determination of whether more persuasive evidence is necessary. The more indicators we identify suggesting greater evidence may be necessary, the less likely it is that inquiry alone will suffice. Our inquiries may also provide us with information that leads us to reassess the appropriate level of evidence over the rollforward period.

> For example, suppose we originally determined that inquiry alone was sufficient to address the rollforward period for a control. Our inquiries then lead us to identify that employee turnover has occurred that may have affected the control - i.e. increasing the possibility it has changed. We may therefore determine that inquiry alone is no longer sufficient and perform additional procedures during the rollforward period.

1.3 Perform additional testing over the rollforward period [ISA | 1284]

What do we do?

Perform additional testing over the rollforward period.

Why do we do this?

To assess control risk as Controls Reliance, we evaluate the controls over the entire period of reliance - i.e. the period over which we intend to rely on them.

Execute the Audit

When do we perform additional control testing over the rollforward period? [ISA | 1284.1400]

We perform additional procedures beyond inquiry to roll forward our conclusions on controls when any of the criteria are met in question "When is inquiry alone not sufficient?".

What if we identify significant changes to the design of the control during the rollforward period and we plan to test the new or modified control? [ISA | 1284.1800]

When we identify significant changes to the design of the control during the rollforward period and we plan to test the new or modified control, we are no longer performing rollforward procedures. In order to rely on the new or modified control, we test the operating effectiveness of the new or modified control for the relevant period. We consider if we perform procedures to rollforward our interim conclusion to the point that the modified control began to operate.

What type of rollforward procedures do we perform in addition to inquiry for controls where more persuasive evidence is necessary? [ISA | 1284.2100]

When the factors indicate that more persuasive evidence may be necessary, we may:

- extend the tests of controls performed at interim to cover items during the rollforward period; or
- perform other procedures to test the control during the rollforward period - e.g. if we reperformed the control at interim, we may inspect the control in the rollforward period.

We do not necessarily perform the same audit procedures during the rollforward period as we performed during interim, although it can be effective to do so.

The nature and extent of our rollforward procedures beyond inquiry vary by control and depend on the factors we consider when we determine what additional evidence to obtain during the rollforward period. These factors help us evaluate:

- the risk that the conclusions we reached at an interim date are not consistent with the control's operation during the rollforward period; and
- the impact on our audit approach if we reached the wrong conclusion at interim.

As the risk and impact increases, we increase the persuasiveness of evidence we obtain from our rollforward procedures.

For example, when less persuasive evidence is needed from our rollforward procedures for an automated GITC related to password parameters and enforcement, which the engagement team tested at interim, we could:

- Inquire of the control owner and observe management log-in to a relevant IT layer to verify that a password continues to be required to access the relevant system layer(s) within four months of year-end; or
- Inspect system information that lists the last change date of the password configuration to verify that it has not changed since interim or inspect the change log to confirm that no changes were noted for password configuration.

Alternatively, when more persuasive evidence is needed from our rollforward procedures for an automated GITC related to privileged access rights, which the engagement team tested at interim, we could:

- Inquire of the control owner and test GITC monitoring control(s) related to management's periodic review of privileged access rights within four months of year-end to provide direct evidence that the automated GITC over privileged access rights continues to operate effectively; or
- Test proper approval for any additional individuals who were granted privileged access since interim testwork.

If we choose to extend the tests of controls performed at interim, what sample sizes do we use to rollforward our conclusions on the operating effectiveness of controls? [ISA | 1284.2200]

There are no bright-line tests or specific requirements for the sample sizes we use during the rollforward period. In practice, we may consider a proportional sample size based on the full period samples outlined in Audit Sampling. We could choose to perform more or less testing, but this approach can be a helpful starting point in deciding the extent of testing necessary.

> For example, suppose we tested and concluded on the operating effectiveness of a daily manual control with Elevated RAWTC through Q3. If we decide to perform additional testing procedures during the rollforward period, we may consider performing our procedures over a selection of 5 items - i.e. 3/12 months × 20 sample size.

What do we do if the number of occurrences increases during the rollforward period? [ISA | 1284.12117]

In certain cases, the total number of actual occurrences of a control may end up being more at year-end than expected during the interim period. If this occurs and the increase in the number of occurrences results in the control being akin to an updated frequency (e.g., from weekly to daily), we perform testing over sufficient samples in the rollforward period to meet the sample size for the updated frequency. In this case, because we are essentially re-evaluating our D&I and updating the frequency of the control and then performing the appropriate TOE sample size according to the updated frequency of the control, the additional sample selections will be selected from throughout the period of reliance, inclusive of the rollforward period.

For example, at interim, 45 occurrences exists for a manual control with a Base RAWTC and we do not expect the number of occurrences to increase over 50 by year-end so we determine that the number of occurrences are akin to a weekly frequency and test a sample of 5 based on the sample size table and conclude on our interim TOE. However, as of year-end, we discover that 60 occurrences existed for the year, indicating that the sample size to conclude for the annual period

should be 15 based on a daily frequency. The engagement team tests 10 additional samples in the rollforward period to suffice the 15 sample size for the updated daily frequency for that control.

Examples

How might we modify the nature and extent of rollforward procedures for different levels of RAWTC? [ISA | 1284.2300]

Fact pattern

An engagement team performed tests of four separate controls and concluded on the operating effectiveness of each control at an interim date - i.e. September 30. The team then determined the procedures they would perform for each of the controls during the three-month rollforward period by considering:

- the nature of the control;
- the RAWTC;
- the frequency of the control; and
- the related RMM..

Analysis

The table below describes the four controls tested by the team as of or through an interim date and the team's rationale for the rollforward approach determined for each control.

Control background	Rollforward approach
Control A • Manual control that operates on a recurring basis • Interim testing included inquiry and reperformance • Associated with an RMM whose inherent risk is assessed as Base • Elevated RAWTC due to judgment involved in the operation of the control • Consistent operation and no indication of significant changes to the control in the rollforward period	The inherent risk of the RMM was assessed as Base and no changes to the control were indicated in the rollforward period. However, the Elevated RAWTC led the team to determine that they would perform procedures beyond inquiry. The planned rollforward procedures included inquiry along with inspection and reperformance of the control during the final month of the year.
Control B • Manual control that operates on a recurring basis • Interim testing included inquiry and reperformance • Associated with an RMM whose inherent risk is assessed as Base • Base RAWTC	The inherent risk of the RMM is assessed as Base, no changes to the control were indicated in the rollforward period, which is less than four months, and the RAWTC is Base. The team therefore determined inquiry alone to determine there were no changes in the control in the rollforward period

• Consistent operation and no indication of significant changes to the control in the rollforward period which is less than four months.	was sufficient to rollforward their interim conclusions to period end.
Control C • Management review control that operates monthly and requires significant judgment • Interim testing included inquiry, inspection of documentation and reperformance • Associated with a significant risk • Significant RAWTC • Consistent operation and no indication of significant changes to the control in the rollforward period	The significant risk, Significant RAWTC and the complex nature of the control itself led the team to determine that procedures beyond inquiry alone were necessary. The team performed inquiries and selected the period end - i.e. December 31 - occurrence of the monthly control for reperformance as their rollforward procedures.
Control D • Automated control that operates on a recurring basis • Interim testing included inquiry, reperformance, inspection • Associated with an RMM whose inherent risk is assessed as Base • Base RAWTC • Consistent operation and no indication of significant changes to the control in the rollforward period • Effective general IT controls and no changes to the effectiveness of the related general IT controls	The inherent risk of the RMM was assessed as Base, no changes to the automated control were indicated in the rollforward period, the RAWTC is Base, and the related general IT controls were also tested and determined to be effective. The team therefore determined inquiry alone was sufficient to rollforward their interim conclusions to period end.

Using audit evidence obtained in previous audits and controls over significant risks

International Standards on Auditing: ISA 330.13-15

Using audit evidence obtained in previous audits

13. In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:

(a) The effectiveness of other components of the entity's system of internal control, including the control environment, the entity's process to monitor the system of internal controls, and the entity's risk assessment process;

(b) The risks arising from the characteristics of the control, including whether it is manual or automated;

(c) The effectiveness of general IT controls;

(d) The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control;

(e) Whether the lack of a change in a particular control poses a risk due to changing circumstances; and

(f) The risks of material misstatement and the extent of reliance on the control. (Ref: Para. A36)

14. 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:

(a) 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. (Ref: Para. A37)

(b) 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. (Ref: Para. A38-A40)

Controls over significant risks

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

ISA Application and Other Explanatory Material: ISA 330.A36-A40

Using audit evidence obtained in previous audits (Ref: Para. 13)

A36. In certain circumstances, audit evidence obtained from previous audits may provide audit evidence where the auditor performs audit procedures to establish its continuing relevance and reliability. For example, in performing a previous audit, the auditor may have determined that an automated control was functioning as intended. The auditor may obtain audit evidence to determine whether changes to the automated control have been made that affect its continued effective functioning through, for example, inquiries of management and the inspection of logs to indicate what controls have been changed. Consideration of audit evidence about these changes may support either increasing or decreasing the expected audit evidence to be obtained in the current period about the operating effectiveness of the controls.

Controls that have changed from previous audits (Ref: Para. 14(a))

A37. Changes may affect the relevance and reliability of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance. For example, changes in a system that enable an entity to receive a new report from the system probably do not affect the relevance of audit evidence from a previous audit; however, a change that causes data to be accumulated or calculated differently does affect it.

Controls that have not changed from previous audits (Ref: Para. 14(b))

A38. The auditor's decision on whether to rely on audit evidence obtained in previous audits for controls that:

(a) have not changed since they were last tested; and

(b) are not controls that mitigate a significant risk,

is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment, but is required by paragraph 14 (b) to be at least once in every third year.

A39. In general, the higher the risk of material misstatement, or the greater the reliance on controls, the shorter the time period elapsed, if any, is likely to be. Factors that may decrease the period for retesting a control, or result in not relying on audit evidence obtained in previous audits at all, include the following:

- A deficient control environment.
- A deficiency in the entity's process to monitor the system of internal controls.
- A significant manual element to controls.
- Personnel changes that significantly affect the application of the control.
- Changing circumstances that indicate the need for changes in the control.
- Deficient general IT controls.

A40. When there are a number of controls for which the auditor intends to rely on audit evidence obtained in previous audits, testing some of those controls in each audit provides corroborating information about the continuing effectiveness of the control environment. This contributes to the auditor's decision about whether it is appropriate to rely on audit evidence obtained in previous audits.

How do we comply with the Standards? [ISA | KAEGHDWC]

1.C Core and Less Complex | Use prior year audit evidence for testing automated process control activities [ISA | 4583]

What do we do?

Incorporate knowledge obtained during past audits when determining the nature, timing, and extent of tests of controls in subsequent years

Why do we do this?

In planning an effective and efficient audit, we may be able rely on prior period audit evidence regarding the operating effectiveness of automated process control activities, where deemed appropriate.

Execute the Audit

Core and Less Complex | When can we use the audit evidence obtained during previous audits to conclude on the operating effectiveness of automated process control activities? [ISA | 4583.1300]

We can do this if we choose to use a benchmarking strategy to conclude on the operating effectiveness of automated process control activities. We still obtain evidence as part of the current audit to:

- ascertain whether the design of the automated process control activity has changed from prior periods; and
- determine that relevant general IT controls are operating effectively.

We also incorporate knowledge obtained during prior audits when determining the nature, timing, and extent of evidence necessary to conclude on the operating effectiveness of the automated process control activity for the current audit.

How do we incorporate knowledge obtained during previous audits when determining the nature, timing, and extent of our control testing? [ISA | 4583.1400]

To incorporate knowledge obtained during previous audits, we think about the following when assessing risk associated with a control in the subsequent years' audit:

- The nature, timing, and extent of procedures performed in previous audits;
- The results of the previous years' testing of the control; and
- Whether there have been changes in the control or the process in which it operates since the previous audit.

What do we do to incorporate knowledge obtained during past audits in subsequent years when determining the nature, timing and extent of our control testing? [ISA | 4583.12093]

To incorporate knowledge obtained during past audits when determining the nature, timing, and extent of tests of controls in subsequent years, we:

- Take additional factors into account when we assess risk associated with controls.
- Use a benchmarking strategy to test the effectiveness of automated process control activities, if applicable.
- Vary the nature, timing, and extent of tests of controls to incorporate unpredictability and respond to changes.

How do we incorporate the results of the previous year's testing of the control? [ISA | 4583.12095]

After we take into account the factors when we assess the risk associated with the control (RAWTC), the additional information from prior year might result in us assessing the RAWTC lower than in the previous year when we had increased the RAWTC above inherent risk in the previous year.

1.E Enhanced | Incorporate knowledge from past audits [ISA | 1270]

What do we do?

Incorporate knowledge obtained during past audits when determining the nature, timing, and extent of tests of controls in subsequent years.

Why do we do this?

We use the knowledge we obtained in past audits as part of our risk assessment. We may also rely on the operating effectiveness of automated controls (excluding GITCs) obtained in prior years if we perform the relevant procedures to do so in appropriate circumstances.

Execute the Audit

Enhanced | When can we use the audit evidence obtained during previous audits to conclude on the operating effectiveness of controls? [ISA | 1270.1300]

We can do this for automated controls (excluding GITCs) where we choose to use a benchmarking strategy[1271] to conclude on the operating effectiveness of automated controls. We still obtain evidence as part of the current audit to:

- ascertain whether the design of the automated control has changed from prior periods; and
- determine that relevant general IT controls are operating effectively.

We cannot use audit evidence obtained during previous audits to conclude on the operating effectiveness of a manual control for the current audit. For each relevant manual control, we obtain evidence to conclude on the design and operating effectiveness of the control as part of the current audit.However, we incorporate knowledge obtained during prior audits when determining the nature, timing, and extent of evidence necessary to conclude on the operating effectiveness of the control for the current audit.

How do we incorporate knowledge obtained during previous audits when determining the nature, timing, and extent of our control testing? [ISA | 1270.1400]

To incorporate knowledge obtained during previous audits, we think about the following when assessing risk associated with a control in the subsequent years' audit:

- The nature, timing, and extent of procedures performed in previous audits;
- The results of the previous years' testing of the control; and
- Whether there have been changes in the control or the process in which it operates since the previous audit.

What do we do to incorporate knowledge obtained during past audits in subsequent years when determining the nature, timing and extent of our control testing? [ISA | 1270.12142]

To incorporate knowledge obtained during past audits when determining the nature, timing, and extent of tests of controls in subsequent years, we:

- Take additional factors into account when we assess risk associated with controls.
- Use a benchmarking strategy to test the effectiveness of automated controls (excluding GITCs), if applicable.
- Vary the nature, timing, and extent of tests of controls to incorporate unpredictability and respond to changes.

How do we incorporate the results of the previous year's testing of the control? [ISA | 1270.12143]

After we take into account the factors when we assess the risk associated with the control (RAWTC), the additional information from prior year might result in us assessing the RAWTC lower than in the previous year when we had increased the RAWTC above inherent risk in the previous year.

1.1 Use a benchmarking strategy to test automated controls [ISA | 1271]

What do we do?

IF we plan to use a benchmarking strategy to conclude on the operating effectiveness of an automated control (excluding GITCs), THEN perform relevant procedures.

Why do we do this?

We obtain evidence about the design and effectiveness of controls during the period under audit, but we are permitted to use evidence from prior years when we take a benchmarking approach. There are limitations on when we can use benchmarking, and other evidence we obtain in the period of reliance in order to rely on benchmarking evidence.

Execute the Audit

Can we benchmark a general IT control (GITC)? [ISA | 1271.8478]

No, we do not use a benchmarking strategy for general IT controls (GITCs).

What is benchmarking? [ISA | 1271.1300]

Benchmarking automated controls uses a combination of audit evidence obtained in a past audit - i.e. the baseline - and audit evidence in the current year that the operation of the automated control has not changed, to conclude on whether the automated control is implemented and operating effectively in the current period under audit.

What is the baseline? [ISA | 1271.12068]

The baseline is the test we performed over the design, implementation and operating effectiveness of the automated control and the evidence we obtained to support its design, implementation and operating effectiveness in a past audit. This test is considered the baseline - or benchmark - for the automated control.

What do we do to test an automated control using benchmarking? [ISA | 1271.1500]

We do this in the following steps for automated controls:

- Determine whether it is appropriate to use a benchmarking strategy
  - Consider our assessment of RAWTC and other risk factors
  - Determine whether it is necessary to re-establish a baseline
- Determine the automated control has not changed since the baseline

Are there drawbacks to using a benchmarking strategy? [ISA | 1271.1600]

It depends. A benchmarking strategy may be less efficient than testing the operating effectiveness of the control in the current period. Even when a benchmarking strategy is appropriate, we decide whether to use it by weighing the incremental efficiency benefit against the additional risk.

In some cases, we may find that using a benchmarking strategy doesn't provide a significant benefit when compared to the increased risks.

Do we still obtain an understanding of the process and evaluate the design and implementation of automated controls when using a benchmarking approach? [ISA | 1271.1700]

Yes. When we use a benchmarking strategy, we still:

- understand the process;
- identify the applicable process risk points;
- evaluate the design of the automated controls; and
- test the operating effectiveness of the relevant general IT controls.

This is performed at the same time and in the same way as for controls that we do not benchmark. It's the next steps - the tests of implementation and operating effectiveness - where our benchmarking approach differs.

How do we evaluate the design of an automated control when we use a benchmarking strategy? [ISA | 1271.1800]

When we evaluate the design of automated controls we plan to test using a benchmarking strategy, we consider the combination of:

- evidence we obtained in prior periods when evaluating the design and implementation and testing the operating effectiveness as part of establishing the baseline; and
- evidence we obtain in the current period to determine that the automated control has not changed since the baseline and that no changes are necessary.

If we concluded the design of an automated control was effective in prior periods, does this automatically allow us to conclude the design is effective in the current period? [ISA | 1271.1900]

No. When we evaluate the design of the automated control in the current period, we cannot not simply conclude the automated control is designed effectively based on the conclusion reached during the past audit. We also consider whether there are any changes in circumstances since the baseline that may affect the design of the automated control, such as:

- changes in materiality;
- changes in processes and related process risk points - i.e., the where and how a material misstatement could occur;
- changes in related files, tables, data, and parameters the automated control relies on.

When changes are necessary and management has not updated the design of the automated control to address these changes, we conclude the design of the automated control is ineffective.

What do we include in our documentation when we use a benchmarking strategy? [ISA | 1271.2000]

When we plan to use a benchmarking strategy, we include in our audit documentation for the automated control:

- sufficient and appropriate audit evidence we obtained in the prior periods relating to our evaluation of the design and implementation of controls and our tests of their operating effectiveness;
- the procedures we performed to determine that the design of the subject controls have not changed since our last evaluation;
- the date we last performed the baseline; and
- the conclusions we reached about relying on controls that were tested in previous audit.

Do we perform rollforward procedures when we use a benchmarking approach? [ISA | 1271.8479]

When our procedures to evaluate the appropriateness of using a benchmarking approach (e.g. determining the automated control has not changed) are performed prior to period end, then we perform rollforward procedures (see activity 'Determine additional evidence for the rollforward period, if applicable').

1.1.1 Determine whether it is appropriate to use a benchmarking strategy [ISA | 1272]

What do we do?

Determine whether it is appropriate to use a benchmarking strategy to test automated controls (excluding GITCs).

Why do we do this?

We obtain evidence about the design, implementation and operating effectiveness of controls during the period under audit, but we are permitted to use evidence from prior years when we take a benchmarking approach. There are limitations on when we can use benchmarking, and specific audit evidence we obtain in the period of reliance in order to rely on benchmarking evidence.

Execute the Audit

Can we benchmark a general IT control (GITC)? [ISA | 1272.8478]

No, we do not use a benchmarking strategy for general IT controls (GITCs).

What do we do to determine whether it is appropriate to use a benchmarking strategy to test an automated control? [ISA | 1272.1300]

To determine whether it is appropriate to use a benchmarking strategy for an automated control, we:

- consider our assessment of RAWTC for the automated control, including whether the RAWTC for the automated control is assessed as Significant or Significant+, and other risk factors
- determine whether it is necessary to re-establish the baseline

1.1.1.1 Consider our assessment of RAWTC and other risk factors [ISA | 1274]

What do we do?

Determine whether it is appropriate to use a benchmarking strategy by considering the RAWTC assessed for the automated control (excluding GITCs) and our assessment of other risk factors.

Why do we do this?

We may use a benchmarking strategy, which uses a combination of prior-period evidence and evidence we obtain in the current period, to test the operating effectiveness of automated controls (excluding GITCs). However, this depends on the RAWTC assessed for the automated control and some specific additional risk factors. If our assessment indicates that a benchmarking strategy is inappropriate, a benchmarking strategy would not provide evidence on the operating effectiveness of the control in the current period. Using this evidence may therefore lead us to reach an inappropriate conclusion on the operating effectiveness of the automated control.

Execute the Audit

What risk factors do we assess to determine whether it is appropriate to use a benchmarking strategy to test automated controls? [ISA | 1274.1300]

The risk factors we assess to determine whether it is appropriate to use a benchmarking strategy to test automated controls (excluding GITCs) are:

- the RAWTC assessed for the automated control (see the activity "Assess RAWTC" and sub-activities for guidance on how to assess RAWTC);
- the following three additional risk factors:
  - the extent to which the automated control can be matched to a defined program within an application;
  - the extent to which the application is stable - i.e., there are few changes from period to period; and
  - the availability and reliability of a report of the compilation dates of the programs placed in production. (This information may be used as evidence that controls within the program have not changed).

Can we benchmark a general IT control (GITC)? [ISA | 1274.8478]

No, we do not use a benchmarking strategy for general IT controls (GITCs).

Can we use a benchmarking strategy when we assess RAWTC for an automated control as Significant or Significant+? [ISA | 1274.1400]

No. When we have assessed RAWTC for an automated control as Significant or Significant+, we cannot use a benchmarking strategy to test the operating effectiveness of the automated control in the current period.

What additional risk factors do we consider when we determine whether a benchmarking strategy is appropriate? [ISA | 1274.1500]

For each risk factor that we evaluate to determine whether a benchmarking strategy is appropriate for testing automated controls (excluding GITCs), the table below provides indicators and examples of

when the risk factor is higher - and benchmarking is less appropriate - and the risk factor is lower - and benchmarking is more appropriate for the automated control.

Risk factor	Indicator that risk factor is higher (and benchmarking is less appropriate)	Indicator that risk factor is lower (and benchmarking is more appropriate)
Extent to which the automated control can be matched to a defined program within an application	The automated control cannot be matched to a defined program within an application - e.g., the entity has an automated process control activity in place over the system configuration of a specific report but the program change log does not clearly indicate the specific program name that relates to the specific system configuration control	The automated control can be matched to a defined program within an application - e.g., the entity has an automated process control activity in place over the system configuration of a specific report and the change log clearly indicates program names that can be associated with the specific system configuration control being tested
Extent to which the application is stable (i.e. few changes occur from period to period).	An application is dynamic, and the entity frequently makes changes to it - e.g., an entity with a large customized ERP system has an in-house IT administration group that processes several ongoing program changes that aim to change or improve the functionality and capabilities of the IT system, so changes in the automated controls may be more likely	An application with few and infrequent changes to the application itself and the related controls - e.g., an entity with legacy systems that are subject to minimal ongoing program changes or an entity that uses purchased software applications but cannot access or modify the underlying program code may be less likely to have changes in automated controls
Availability and reliability of a report of the compilation dates of the programs placed into production (which may provide evidence that controls	There is limited system evidence that documents program changes and when they were placed into production - e.g., where an entity cannot retrospectively generate a complete list of program changes during a period because of limitations within the application, the lack of a reliable program change log for the whole period could increase the risk of unidentified changes to automated controls	There is reliable system evidence available that documents all program changes and when they were placed into production, including an audit trail to evaluate the appropriateness and approval process for those changes - e.g., an entity has the ability to generate a full and complete listing of all program changes during a period that is controlled and cannot be altered

within the program have not changed)		

What is a 'report of the compilation date of the programs placed in production'? [ISA | 1274.12122]

A report of the compilation dates of the programs placed into production lists the dates a program was upgraded or changed. It provides evidence of the number of changes made to the entire program since the baseline was established.

1.1.1.2 Determine whether it is necessary to re-establish a baseline [ISA | 1273]

What do we do?

Determine whether it is necessary to re-establish a baseline of the automated control (excluding GITCs) by considering whether the baseline was established within the past three years and other relevant factors that may indicate the baseline is no longer appropriate.

Why do we do this?

When we use a benchmarking strategy, we first determine whether it is necessary to re-establish the baseline of the automated control. We re-establish the baseline of the automated control once in every third audit or when we identify other factors that indicate the baseline of the automated control is no longer appropriate - e.g., due to changes in circumstances that are likely to impact the effectiveness of the design.

When these factors indicate the baseline is no longer appropriate, we re-establish a baseline and obtain evidence of operating effectiveness in the current year. If we don't, we might inappropriately rely on evidence that is no longer relevant in the current year.

Execute the Audit

Can we benchmark a general IT control (GITC)? [ISA | 1273.8478]

No, we do not use a benchmarking strategy for general IT controls (GITCs).

How often do we re-establish the baseline of an automated control? [ISA | 1273.1300]

We re-establish the baseline of an automated control we are relying on in the current audit at least once every three years - i.e. if we establish a baseline by testing the effectiveness of the automated control in year one (e.g., 20X1 audit), then we re-establish the baseline in year four at the latest (e.g., 20X4 audit).

We re-establish the baseline more often when we identify that the baseline is no longer appropriate. This may occur for a variety of reasons - e.g. because of changes to the design of the control and/or to business factors that are likely to impact the effectiveness of the design.

We evaluate whether the baseline remains appropriate in each audit period in which we rely on the effectiveness of the automated control.

Can we re-establish the baseline for all automated controls in the same audit period? [ISA | 1273.1400]

No. When we use a benchmarking strategy to test a number of automated controls, we re-establish the baseline for some automated controls in each audit period. With respect to automated controls, this helps us avoid:

- testing all controls on which we intend to rely in a single period; and
- not testing any of the controls in the subsequent two audit periods.

If we were to test all controls in a single period, changes may have occurred that affect one or more of those controls. Without performing some testing each year, there is an increased risk that we may fail to identify these changes and properly modify our audit approach. When we use a benchmarking strategy, we therefore stagger our procedures so that we baseline or re-baseline a portion of the automated controls in each audit period.

What other relevant factors do we consider and how may they affect our determination of whether to re-establish a baseline? [ISA | 1273.1500]

In addition to considering whether the baseline was established within the past three audits, we also evaluate the following factors when determining whether to re-establish a baseline:

Factor	Indicator that re-establishing baseline is necessary	Indicator that baseline is appropriate (up to at least once every three years)
Effectiveness of the IT control environment, including controls over application and system software acquisition and maintenance, access controls and computer operations	General IT controls relevant to the automated control are ineffective. When general IT controls relevant to the automated control being benchmarked are ineffective, a benchmarking strategy is no longer appropriate. Further, we may not be able to conclude the automated control is operating effectively in the current period, depending on the impact of the general IT control deficiency and any additional procedures we perform. Once general IT controls are remediated and effective, we could reestablish a baseline by performing	All general IT controls relevant to the automated control are designed, implemented and operating effectively.

	procedures to test the operating effectiveness of the automated control in the current period.	
Auditor's understanding of the nature of any changes on the specific programs that contain the controls	Program changes were made to the applications that contain controls being benchmarked. We do not thoroughly understand those changes or how they potentially affect the automated control being benchmarked. For example, we obtain and inspect program change logs for the application that contains a control being benchmarked. Limitations in system documentation do not allow us to understand how those changes may have affected the automated control being benchmarked. (In this situation, we obtain sufficient evidence to conclude there were no changes to the control being benchmarked so we can use a benchmarking strategy in the first place.)	There are no program changes to the applications that contain controls being benchmarked. There are few program changes to the applications that contain controls being benchmarked. However, we understand those changes sufficiently to conclude they do not affect the automated controls being benchmarked. For example, we obtain and inspect program change logs and other supporting evidence, including change tickets for the application that contains a control being benchmarked. Based on our inspection and inquiry of IT personnel and control owners, we have sufficient evidence to conclude the changes have no impact on the automated control being benchmarked.
Nature and timing of other related tests	The application that includes the control being benchmarked has limited or no tests of other controls. Because we have limited evidence from tests of other controls in the same application, we have less information that may help evaluate the consistency or lack of changes in the	In the current year, we test, multiple other controls related to the application that includes the control being benchmarked. For example, we test other automated controls in the current year that relate to the same application where we plan to use a benchmarking strategy. The results of the

	application and the control being benchmarked.	tests of other controls help us evaluate the consistency or lack of changes in the application itself and the benchmarked control.
Consequences of errors associated with the automated control that was benchmarked	The consequences of errors due to a breakdown in the automated control are greater. We may use our assessment of RAWTC to identify controls where the consequences of errors are higher. An automated control with an assessed RAWTC of Elevated may indicate we need to re-establish the baseline.	The consequences of errors due to a breakdown in the automated control are lower. Our RAWTC assessment is Base.
Whether the control is sensitive to other business factors that may have changed	The control is more sensitive to changes in business factors. Consider whether there are changes in the types of transactions recorded to an account that affect the operation of the automated control. The automated control operates in such a way that changes in the business may affect how it operates, so the baseline may no longer be appropriate.	The control is less sensitive to changes in business factors. For example, the automated process control activity operates over a significant account and related assertion that are stable and there are no changes in the type or nature of transactions that may affect the operation of the automated process control activity. Alternatively, the control is designed to operate over a variety of transaction types - e.g. credits, debits, zero amounts. This decreases its sensitivity to changes, so the baseline may be appropriate.

1.1.2 Determine the automated control has not changed [ISA | 1275]

What do we do?

Determine the automated control (excluding GITCs) has not changed since the date of the last baseline by obtaining sufficient and appropriate evidence.

Why do we do this?

When we apply a benchmarking strategy, we can rollforward the conclusions we obtained in a prior period about an automated control to the current period under audit. Before we do this, we obtain evidence about:

- whether that automated control has changed; and
- if the automated control has changed, the operating effectiveness of the new or modified control.

If we don't, we may not obtain sufficient and appropriate audit evidence to support our reliance on the control.

Execute the Audit

Can we benchmark a general IT control (GITC)? [ISA | 1275.8478]

No, we do not use a benchmarking strategy for general IT controls (GITCs).

How do we determine that the automated control has not changed since the baseline? [ISA | 1275.1300]

To determine that an automated control has not changed since the baseline, we inquire of relevant IT staff, system users - i.e. control owners - and management regarding whether the design of the automated control has changed since the date of the last baseline and perform one or more of the following procedures:

- inspect or observe reports or other evidence of the dates that programs were placed into production;
- inspect or observe program change logs; and/or
- inspect or observe other evidence of changes to IT gathered while testing general IT controls.

When we plan to rely on evidence obtained in the prior period, we not only determine whether the automated control has changed from the prior period. We also consider the continuing relevance of the evidence we obtained in the prior period.

What if there have been changes to the automated control since the date of the last baseline? [ISA | 1275.1400]

When there have been changes to the design of the automated control that affect the continuing relevance of the audit evidence from the previous audit, we evaluate the design and implementation of the updated control and retest the operating effectiveness in the current audit.

How do we determine the nature and extent of audit evidence we obtain to determine that an automated control has not changed? [ISA | 1275.1500]

The nature and extent of audit evidence we obtain to determine that an automated control has not changed varies depending on the control. As with other controls, we determine the level of evidence to obtain by considering:

- the RAWTC of the automated control; and
- the strength of the entity's program change controls.

Examples

How do we determine the automated process control activity has not changed since the baseline? [ISA | 1275.1600]

Scenario 1

Fact pattern

An entity uses an automated process control activity to translate its foreign subsidiary financial results to its consolidated functional currency and calculate the cumulative translation adjustments. The engagement team tested design implementation and operating effectiveness of the automated control in the previous year and it was found to be effective. In addition, the general IT controls that support the on-going effectiveness of the automated control were tested and found to be operating effectively in both the current and prior years.

In addition, the engagement team inquired with the relevant IT staff, system users - i.e. control owners - and management regarding whether the automated process control activity has changed since the baseline date and they indicated that it has not changed. The engagement team corroborated the inquiry by inspecting system reports indicating the dates that programs were placed into production, including evidence gathered in testing the program change GITCs, and determined that the automated control has not changed since the baseline date through the period end date.

Analysis

The team concludes they gathered sufficient evidence to allow them to determine that the automated process control activity has not changed by performing the following:

Benchmark testing at an interim date

- Inquiry of the relevant IT staff, system users - i.e. control owners - and management; and
- Inspection of system reports that indicated the date the program relevant to the automated control was placed into production; and
- Concluding on the effective design, implementation and operation of the relevant GITCs, such as program change controls, throughout the current period; and

Rollforward procedures

- Rollforward inquiries to evaluate if the control had changed between the date of the above procedures and the period end.

As a result, the engagement team was able to rely on the automated process control activity without further testing in the current period.

Scenario 2

Fact pattern

An entity has an automated process control activity in which the system is configured to completely and accurately identify variances between the purchase order, goods shipped, and the invoice. The engagement team tested the automated process control activity and the related GITCs in the previous year and they were found to be operating effectively.

In the current year, the engagement team observed the system configuration and noted the last change date was during the period under review. The team identified a change was made to the configuration whereas the system is now configured to completely and accurately identify variances between the purchase order and the invoice.

Analysis

The team concludes there was a change identified in the system configuration process control activity during the period under review. As such the team will reestablish the baseline by testing the design, implementation and operating effectiveness of the control after the change was implemented.

2.C Core and Less Complex | Use prior period audit evidence for testing of manual process control activities [ISA | 5580]

What do we do?

IF we plan to use audit evidence obtained on prior period audits to conclude on the operating effectiveness of a manual process control activity, THEN perform relevant procedures.

Why do we do this?

We determine whether it is appropriate to use evidence about the operating effectiveness of process control activities obtained in prior periods. When those relevant controls are manual in nature and rely on the performance by an individual, there is a greater risk that the manual control will not continue to operate on a consistent basis.

Accordingly, we consider factors to help us determine whether it is appropriate to use evidence about the operating effectiveness of manual controls obtained in prior periods.

Execute the Audit

Core and Less Complex | In what circumstances may we use prior period audit evidence to conclude on the operating effectiveness of manual process control activities? [ISA | 5580.1300]

We may use prior period audit evidence for the operating effectiveness of manual process control activities in the current period when all of the following conditions are met:

- the risk associated with the control (RAWTC) is not assessed as Significant or Significant+;
- we have performed procedures to establish the continuing relevance and reliability of the prior period audit evidence by:
  - performing a walkthrough of the business process containing the control; and

- evaluating that both the design and implementation is effective in the current period and has not significantly changed from the previous audit;

- we have evaluated the Monitoring Activities component of CERAMIC and concluded that it is appropriate; and
- we have tested the operating effectiveness of the control at least once in the past two audit periods.

Core and Less Complex | How does our evaluation of the Monitoring Activities component of CERAMIC help us establish the continuing relevance and reliability of prior period audit evidence in a smaller entity? [ISA | 5580.6244]

In a smaller entity, the Monitoring Activities component of CERAMIC helps to establish the continuing relevance and reliability of prior period audit evidence, as management's close involvement in operations and monitoring improves the likelihood that management will be aware of any changes in controls and inform us accordingly.

Core and Less Complex | How do we establish the continuing relevance and reliability of evidence from previous audits? [ISA | 5580.12220]

When we plan to use the audit evidence obtained in the prior period about the operating effectiveness of manual process control activities, we 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. We obtain this evidence by performing the following procedures:

- we perform a walkthrough of the business process containing the control we intend to use audit evidence from previous audits in order to confirm our understanding of (i) this business process, (ii) those specific controls and (iii) whether there have been any significant changes in the activities or "the process risk point" in the process;
- we evaluate the design and implementation of the control we rely on in the current period and we conclude that both the design and implementation is effective in the current period and has not significantly changed since the previous audit.

Core and Less Complex | What if there have been significant changes to the manual process control activities since the previous audit? [ISA | 5580.1500]

When there have been significant changes to the design of the manual process control activities that affect the continuing relevance and reliability of the audit evidence from the previous audit, we re-test the operating effectiveness of the control for the period since the control changed in the current audit if we still plan to rely on this specific control.

Core and Less Complex | How often do we re-test the operating effectiveness of manual process control activities where we use prior period audit evidence? [ISA | 5580.1600]

The length of time between retesting the operating effectiveness of the process control activities we are relying on is a matter of professional judgment. However, we re-test the operating effectiveness of the manual process control activity we are relying on at least once every three audit periods - i.e. if we tested the operating effectiveness of a control in audit period one, then we re-test the operating effectiveness in audit period four at the latest.

When we intend to use audit evidence obtained in previous audits for multiple manual process control activities, we stagger our testing so that we perform some testing during each audit. This provides corroborating information about the continuing effectiveness of the control environment and contributes to our decision about whether it is appropriate to use audit evidence obtained in previous audit for other manual process control activities.

Core and Less Complex | What do we consider when determining whether to re-test the operating effectiveness of manual process control activities in the current period? [ISA | 5580.1700]

In addition to considering whether the testing of the operating effectiveness of the manual process control activity was performed at least once in the past two audit periods, we also consider several factors when determining whether to re-test the operating effectiveness of the control or if use of audit evidence obtained in previous audits remains appropriate.

Factors that decrease the period for retesting a manual process control activity or potentially result in not using on audit evidence obtained on previous audits at all, include:

- a deficient control environment;
- deficient monitoring of controls;
- changing circumstances that indicate the need for changes in the control;
- higher RAWTC, i.e. the higher the RAWTC, the shorter the period between testing or, in some cases, less likely to use evidence from the previous audits.

Factor	Indicator to re-test operating effectiveness	Indicator that the previous testing of the operating effectiveness is still appropriate (assuming the control was tested at least once in the past two audit periods)
Effectiveness of other components of internal control, including the Control Environment, the Monitoring Activities, and Risk Assessment components	The Control Environment, Monitoring Activities, and Risk Assessment components of CERAMIC are not appropriate. If the Monitoring Activities component is not appropriate, the use of prior period audit evidence is no longer appropriate.	The Control Environment, Monitoring Activities, and Risk Assessment components of CERAMIC are appropriate.
Changing circumstances that indicate the need for changes in the control	We identified changing circumstances that indicate changes in the operation of the manual process control activity are necessary.	We did not identify any changing circumstances that indicate changes in the operation of the manual process control activity are necessary.

	When there have been significant changes in the entity and its environment, process activities and/or process risk points (PRPs), modifications to the control and how it operates are generally necessary for the control to continue to mitigate the relevant risks.	
The RAWTC of the control	When RAWTC is Elevated, the potential implications of a control failure are often greater. As a result, more frequent testing (i.e., more frequently than once every three periods) is appropriate. When RAWTC is Significant or Significant+, the use of prior period audit evidence is not allowed.	When RAWTC is Base, the likelihood that the control will fail to operate effectively is lower. As a result, less frequent testing (i.e., once every three periods) is appropriate.

Core and Less Complex | How do we incorporate the results of the previous period's testing of the control? [ISA | 5580.1800]

If we plan to use audit evidence about the operating effectiveness of a manual process control activity obtained in previous audits, we include in our audit documentation:

- Audit evidence from prior periods relating to our evaluation of the design and implementation of the specific control and our test of the operating effectiveness;
- Procedures performed to determine that no changes in the design or implementation of the subject manual control have occurred since we last tested the controls;
- Conclusions reached about relying on such manual control that was tested in a previous audit.

Core and Less Complex | Do we perform rollforward procedures when we use prior period evidence for testing manual process control activities? [ISA | 5580.7476]

When our procedures to evaluate the appropriateness of using prior period audit evidence (e.g. walkthrough of the business process and evaluation of design and implementation of the manual process control activity) are performed prior to period end, then we perform rollforward procedures (see activity 'Determine additional evidence for the rollforward period, if applicable').

Evaluating the Operating Effectiveness of Controls

International Standards on Auditing: ISA 330.16-17

Evaluating the Operating Effectiveness of Controls

16. When evaluating the operating effectiveness of controls upon which the auditor intends to rely, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective. (Ref: Para. A41)

17. If deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether: (Ref: Para. A42)

(a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;

(b) Additional tests of controls are necessary; or

(c) The risks of material misstatement need to be addressed using substantive procedures.

ISA Application and Other Explanatory Material: ISA 330.A41-A42

Evaluating the Operating Effectiveness of Controls (Ref: Para. 16-17)

A41. A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control.

A42. The concept of effectiveness of the operation of controls recognizes that some deviations in the way controls are applied by the entity may occur. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions and human error. The detected rate of deviation, in particular in comparison with the expected rate, may indicate that the control cannot be relied on to reduce risk at the assertion level to that assessed by the auditor.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Perform relevant procedures when control deviations are identified [ISA | 1285]

What do we do?

IF we identify deviations when testing controls, THEN perform relevant procedures.

Why do we do this?

Control deviations are present when a control does not operate consistently as designed. When performing a test of controls, we define what constitutes a control deviation in relation to the purpose of the test of controls. When a deviation is identified, we understand them in order to evaluate whether they

indicate a control deficiency, or whether they are the result of an acceptable level of human error within the prescribed design of the control.

Execute the Audit

What 'relevant procedures' do we perform when we identify control deviations? [ISA | 1285.1300]

We perform the following relevant procedures when we identify control deviations:

- Consider the nature, cause and potential consequences of the control deviations;
- Determine the effect of control deviations.

What is a control deviation? [ISA | 1285.1400]

A deviation is an instance where the control does not operate in the way it was designed. Deviations may occur for many reasons - e.g. where the control:

- was not performed on a timely basis;
- did not include the elements it was supposed to;
- is not supported by retained evidence of its operation (if applicable); or
- did not operate at the right level of precision.

Sometimes a deviation is an isolated instance, and sometimes it is a consistent (systematic) failure to operate the control as designed, which is a deficiency in the operating effectiveness of the control.

Is a control deviation the same as a misstatement?

No. A deviation is an item that does not have an expected characteristic - i.e., for a control deviation, it is missing the application of the control. A misstatement refers to the difference between the recorded book value and the audit value. A control deviation does not indicate that a misstatement actually exists.

If we identify a control deviation, do we consider the monetary amount of the related transaction? [ISA | 1285.12065]

No, we do not consider the monetary amount of the related transaction when we identify a control deviation.

We evaluate operating effectiveness in terms of the rate (number) of control deviations and we do not consider the monetary amount of the transactions related to control deviations to determine whether the control is effective or not.

> For example, we are testing the operating effectiveness of a monthly bank reconciliation through inspection. One control attribute is designed to agree the balance per the bank statement to the bank reconciliation within USD 1. When we tested the control through inspection, we found that the bank balance per the reconciliation differs from the bank statement by $10,000, but the difference was not identified by the control operator.
>
> This is a control deviation. Even though the $10,000 difference may be immaterial to our audit, it is an indication that the control did not operate consistently as designed.

1.1 Consider the nature, cause and potential consequences of control deviations [ISA | 1286]

What do we do?

IF we identify control deviations THEN consider the nature, cause and potential consequences of the control deviation.

Why do we do this?

Understanding the nature of a control deviation and its causes, can be helpful as we consider whether the control deviation has additional impacts on our audit.

Execute the Audit

What does 'nature and cause' of a control deviation mean? [ISA | 1286.1300]

The 'nature' refers to what the deviations is. For example, authorization of a bank payment not being performed.

The cause is *why* the deviation occurred. For example, the deviation arose due to human error or fraud.

How do we identify the nature and cause of a control deviation? [ISA | 1286.1400]

We make specific inquiries to understand the nature of control deviations, their cause and potential consequences.

What are the possible causes of a control deviation and what are their potential consequences? [ISA | 1286.1500]

The following table illustrates the possible causes of control deviations and their potential consequences:

Cause of a control deviation	Potential consequence
Systematic deviations are control deviations that are not random, isolated instances or issues that occur by chance. These deviations arise from inaccuracies or issues that are inherent in how the control is designed or operates. When the deviation is caused by systematic issues, the control is likely ineffective. Making this determination is not always straightforward. A control deviation that initially appears as a random, isolated mistake	When a deviation is caused by systematic issues, we: • conclude that the control is ineffective; • identify and evaluate control deficiencies.

may be caused a systematic issue - e.g. a control operator who doesn't understand their responsibilities or changes in the nature of transactions subject to the control. We therefore seek to understand the nature and cause of the deviation and evaluate deviations that appear to be isolated.	
Intentional deviations are control deviations resulting from an intentional action of the control operator or other management. These deviations may be indicative of fraud.	When we identify that a control deviation was intentional, we consider the possible implications of fraud and the impact on our audit approach. We re-evaluate our risk assessment conclusions and determine whether there are fraud risks we did not previously identify.
Control deviations share a common feature	If control deviations share a common feature this may be intentional, and may indicate the possibility of fraud.
Possible Fraud	If the cause of the control deviation is suspected fraud, even if the amount may not be material, we complete the activities within the *Fraud* chapter (AS 2401, ISA 240, AU-C 240). The discovery of suspected fraud may result in a broader consideration of possible implications than does the discovery of an error.
Inability to perform procedures on the control	We consider the reason we are unable to perform the procedures and any impact to our risk assessment (including risk of fraud), our assessment of the integrity of management or employees and possible effects on other aspects of the audit.
Isolated instance of human error	First we understand the deviation in order to evaluate whether the deviation is really isolated. What can initially seem like an honest mistake can sometimes be a pattern of consistent failure to operate a control as designed.

	If a single deviation does seem to be an isolated instance, we can validate that by extending our sample if it is a recurring manual control and we have not tested a larger sample size that enables us to accept a small number of deviations. See Audit Sampling for further guidance on when and how to extend a controls sample.

What do we do if we believe a deviation is an anomaly? [ISA | 1286.1700]

If we believe that a deviation is an anomaly then we perform relevant procedures for control anomalies in *Audit Sampling*.

Is the lack of documentation of a manual control's operation a deviation? [ISA | 1286.1900]

Maybe. Some level of evidence is necessary to conclude that the manual control operated as designed.

For more formalized control structures and for certain controls the design of the control may include clear documentation of the control's performance, then lack of such documentation may be considered a deviation.

For other controls, however, documentation may not be available or relevant. For example, documentation of operation may not exist for some types of controls, such as controls performed by a computer. In such circumstances, audit evidence about operating effectiveness may be obtained through inquiry in combination with other audit procedures such as observation or the use of CAATs.

Is the lack of documentation of an automated control's operation a deviation? [ISA | 1286.2000]

For automated controls, documentation of the control's performance may not be available, so we may obtain evidence of the control's operating effectiveness using different methods. Regardless of the method used, we obtain evidence that all of the attributes of the automated control were operating effectively.For example, we may:

- inspect configuration settings in an IT system;
- re-perform the business rules configured in an IT system for a single transaction - e.g., manually validate the intended processing and output of the configuration settings;
- re-perform the business rules configured in an IT system for all transactions - e.g., using computer assisted audit techniques (CAATs) to validate the intended processing and output of the configuration settings;
- observe the business rules configured in an IT system - e.g., executing a test transaction to validate the intended processing and output of the configuration settings.

In a typical scenario where an automated process control activity is applied to every transaction, inspecting the configuration settings in an IT system may be the most appropriate testing technique. However we may not be able to inspect the IT system settings because of the way the automated process control activity is implemented in the system - e.g. when the configuration exists within pre-packaged applications and management does not have access to the underlying source code of the application. In these instances, we may perform other procedures, including:

- inquiry of personnel with knowledge of the IT system configuration functionality; and
- performing one of the other procedures listed above, such as re-performing the business rules configured in an IT system or observing the business rules configured in an IT system by executing a test transaction.

Examples

Is the lack of documentation of a control's operation a deviation? [ISA | 1286.2200]

Fact pattern

At month end, the accounting manager reviews a proposed expense reimbursement report before payments are issued. As part of the review, the accounting manager:

- agrees each proposed disbursement to the original invoices;
- identifies any proposed expense reimbursement that does not agree to the underlying invoice;
- obtains department supervisor approval for proposed reimbursements without associated invoices based on proof of the employee's payment via company credit card; and
- signs and dates the report.

The entity has controls over the completeness and accuracy of the reports, which have been tested by the engagement team and found to be operating effectively.

The engagement team obtains the proposed expense reimbursement report and observes evidence of review - i.e. notes showing payments agreed to invoices, department supervisor approval - but the reimbursement report is not signed or dated.

Analysis

The report was not signed and dated, but there was sufficient evidence that the review was performed. Assuming the appropriate outliers were followed up on, the control is designed appropriately and there is no deviation. To confirm that there is no control deviation and conclude on the control's operating effectiveness, the team obtains evidence that the review was performed at the right time and before the payments were made.

1.2 Determine the effect of control deviations [ISA | 621]

What do we do?

IF we identify deviations when testing controls, THEN determine the effect of the deviations on the risk associated with the control and the evidence we obtain as well as the operating effectiveness of the control

Why do we do this?

When we assess control risk, we are looking to reach the right conclusion about the operating effectiveness of controls we test. If we conclude a control is operating effectively when it is not, we may make the wrong control risk assessment and perform insufficient substantive procedures.

When our tests reveal no deviations in a control's operation, our conclusion is straightforward. But when we identify deviations, we perform additional procedures, including evaluating their possible effect on the

purpose of the audit procedure and on other areas of the audit before we can conclude on the operating effectiveness of the control.

Execute the Audit

How do we consider the effect of the deviation on the control's RAWTC? [ISA | 621.1300]

Our understanding of the underlying cause of a deviation may change our initial views on the factors we used to evaluate the RAWTC - e.g. a deviation may reveal that the level of complexity and judgment associated with a control is higher than we thought.

When we reconsider the relevant factors in determining RAWTC, we may revise our initial assessment of the RAWTC. This could affect the nature, timing and extent of procedures to continue testing the control (see Audit Sampling) or the extent of our later testing of the remediated control.

We also consider how a systematic deviation may affect the RAWTC for:

- other controls in the process; and
- other components of internal control, including any controls within the control environment, risk assessment process and the monitoring of controls.

How do we determine whether a control deviation is a control deficiency? [ISA | 621.1400]

It can be helpful to think about the following questions to determine whether a deviation is a control deficiency.

- How was the deviation detected?

  For example, detection by another control may signify an effective detective control, while detection through management or our testing may indicate a deficiency.

- Is the deviation confined to a single location, process or application, or is it pervasive across the entity?

  When we test homogeneous locations and assess that a control deviation is isolated to that location, this finding may be inconsistent with and undermine our assessment that the locations are homogeneous.

- How significant is the control deviation from stated policy?

  For example, was the control performed late but still before the financial statements were prepared, or was the control not performed at all?

- How often were deviations detected in relation to how frequently the control is performed?

  When performing control sampling, our evaluation of the number of actual deviations vs. the number of expected deviations assists us in determining whether a control is deficient.

When is a deviation a control deficiency? [ISA | 621.12108]

A deviation results in a control deficiency in the following circumstances:

- The deviation is systemic or intentional based on our consideration of the nature and cause of the deviation (see activity 'Consider the nature, cause and potential consequences of control deviations' for further guidance);
- The deviation is identified for any of the following types of controls:

- Periodic controls, including those that may be akin to recurring controls based on the number of occurrences; or
- Automated controls

- The deviation is identified in a General IT control
- The deviation is identified in a control related to an RMM for which we are not able to get all our evidence from substantive procedures alone
- When testing controls at homogeneous locations and we identify more than one deviation at the same location

When can we accept a deviation and conclude that a control is operating effectively? [ISA | 621.12109]

When we encounter deviations for manual recurring controls that do not result in a control deficiency (see applicable guidance in Q&A 'When is a deviation a control deficiency?'), once we have obtained an appropriate understanding of the identified control deviation, we may accept deviations for manual recurring controls and conclude the control is operating effectively in certain circumstances:

Circumstance	Relevant criteria to accept deviations and conclude the control is operating effectively
Our sample size was based on the 'control sample size table'	Only one deviation was identified in the initial sample size; We tested an extended sample size equal to at least the initial sample size; and No deviations were identified in the additional testing of the extended sample size
Sample size was an increased sample size and we met the criteria based on the applicable guidance in Q&A 'What are the criteria to accept deviations when we increase our sample size for manual recurring controls?'	The total number of deviation(s) is acceptable for the sample size under the applicable guidance in Q&A 'How many control deviations may we accept?'
The control was tested across more than one homogeneous location AND the initial sample size was allocated across the locations that were visited based on the applicable guidance	Only one deviation identified at any single location; Sample size for the location(s) where a deviation was identified was extended by at least five samples AND no further deviations were identified (see further guidance in Q&A 'Homogeneous Locations | What do we do when determining the number of deviations we may accept when testing at more than one location?); and If the sample size is an increased sample size, the total number of deviation(s) is acceptable for the sample size

	under the applicable guidance in Q&A 'How many control deviations may we accept?'; or If the sample size was based on the 'control sample size table', we tested an extended sample size across the locations equal to at least the initial sample size and no deviations were identified in the additional testing of the extended sample size.

Do we always accept deviations when we meet the relevant criteria to accept control deviations in our sample for a manual recurring control? [ISA | 621.12123]

No, we do not always accept deviations when we meet the relevant criteria to accept control deviations. Each time we encounter a deviation we perform the procedures in activity 'Consider the nature, cause and potential consequences of control deviations' to determine whether it is appropriate to accept the deviation, even if we identify less than the maximum number of control deviations we may accept.

How many control deviations may we accept for manual recurring controls, when the sample size has been increased under the applicable guidance and we meet the relevant criteria to accept control deviations in our control sample? [ISA | 621.12124]

The following table illustrates the maximum amount of control deviations we may accept for manual recurring controls, when we have increased the sample size from the 'control sample size table' for manual controls' and we meet the relevant criteria to accept control deviations (see question 'What are the criteria to accept deviations when we increase the sample size for manual recurring controls?'). The amount of control deviations we may accept depends on RAWTC and sample size as determined for controls:

Sample Size (for manual recurring controls)				Maximum number of deviations we can accept
Base RAWTC	Elevated RAWTC	Significant RAWTC	Significant + RAWTC	
50	70	90	110	1
60	81	105	132	2
71	101	132	166	3
85	121	158	198	4
98	141	184	230	5

111	160	209	262	6
124	179	234	292	7
137	198	258	323	8
150	216	282	353	9
163	235	306	383	10*

If our sample size falls between two categories in the table above, we default to the lower maximum number of deviations we can accept.

*We do not accept more than 10 deviations.

If we do not have an appropriate rationale to increase the sample size, see question 'What is the 'control sample size table' for manual controls? for the relevant sample sizes.

Can we accept deviations, when a periodic manual control has a frequency that is akin to a recurring control? [ISA | 621.6223]

No. We cannot accept any control deviations for a periodic manual control, even when the number of occurrences of the manual control is akin to recurring.

> For example, if we are testing the operating effectiveness of monthly bank reconciliations performed on 100 bank accounts, where RAWTC is Base our control frequency is 12 months x 100 accounts = 1,200 occurrences in the period. Therefore, the frequency is more akin to recurring than monthly. However, we still have a frequency of monthly so you cannot use the sample size table that allows for control deviations.

Can we increase our sample size based on the number of control deviations? [ISA | 621.6275]

No. Once we have determined a sample size from the sample size in the table above, we test that sample size.

If we identify more deviations than indicated for the sample size in the table, the control is not effective. For example, say we tested 70 items with base RAWTC, we identify 3 control deviations. We do not test 1 additional item to come to a total of 71, which allows for 3 deviations. In this example, this control would not be operating effectively.

Homogeneous Locations | What do we do when determining the number of deviations we may accept when testing manual recurring controls at more than one location? [ISA | 621.12125]

The following table describes what we do when determining the number of deviations we may accept when testing at more than one location:

Number of deviations identified	What do we do

No more than one deviation identified at any location	We determine whether it is appropriate to accept the deviation in accordance with 'Perform relevant procedures when control deviations are identified', then extend the sample size by 5 items at that location. We also consider whether the deviation causes us to question our initial assessment that locations are homogeneous in accordance with 'Homogeneous Locations | Reassess homogeneity and consider audit impact if we identify contradictory information'). If we conclude it is appropriate to accept the deviation, we identify no further deviations at that location and the number of control deviations in the sample size is less than the maximum we may accept (see 'How many control deviations we may accept, when we meet the relevant criteria to accept control deviations in our control sample?') we may conclude that the control is operating effectively.
More than one deviation identified at the same location	We conclude that the control is ineffective at that location and therefore all locations. We consider whether the deviation causes us to question our initial assessment that locations are homogeneous in accordance with 'Homogeneous Locations | Reassess homogeneity and consider audit impact if we identify contradictory information').
For example, if we test a recurring homogeneous control with a base RAWTC at 20 locations, the sample size is 100 items (i.e., minimum of 5 samples per location) and the maximum number of expected control deviations we may accept in the sample is 5. If one control deviation is detected in each of 3 locations, and no control deviations are detected in the remaining 17 locations, we may conclude that the control is effective, if none of the control deviations are considered to be representative of a systematic or intentional control deviation. However, if we find more than 5 control deviations in total or more than 1 deviation at the same location, we conclude the control is ineffective, reassess homogeneity and do not test additional items or place reliance on this control.	

Homogeneous Locations | What if the deviation(s) identified at the homogeneous locations are anomalies? [ISA | 621.12126]

In the extremely rare circumstances when we consider the deviations discovered to be anomalies that may therefore not be applicable to other locations, we analyze the deviation in accordance with 'Perform relevant procedures for control anomalies'

What is a KPMG Accredited Sampling Professional and what may they do? [ISA | 621.12127]

A KPMG Accredited Sampling Professional is a firm accredited KPMG individual who provides support, assistance and concurrence on sampling related issues. They are not a 'KPMG specialist' or 'specific team member'.

KPMG Accredited Sampling Professionals may be requested to:

- participate in periodic conference calls to discuss sampling matters;
- deliver audit training to audit professionals;
- provide support in engagement team planning decisions; and/or
- review engagement team substantive statistical sampling techniques.

When do we obtain concurrence from a KPMG Accredited Sampling Professional? [ISA | 621.12128]

We obtain concurrence from a KPMG Accredited Sampling Professional when we wish to accept control deviations for manual recurring controls in circumstances other than the following:

- When we are performing a dual-purpose test, the substantive sample size is larger than the indicated control sample size, and we apply our controls testing to the substantive sample;
- When we are testing a control which operates across a number of homogenous locations and we are testing a minimum of 5 operations of the control per location (see 'Allocate the control sample size'); or
- When using the work of internal audit and internal audit has tested a sample larger then the indicated control sample size.

What does 'obtain concurrence from a KPMG Accredited Sampling Professional' mean? [ISA | 621.1701]

When we obtain concurrence from a KPMG Accredited Sampling Professional, they confirm that our conclusion is appropriate.

We evidence the nature of our discussion, individuals involved and the conclusions reached in our engagement documentation when we obtain concurrence. In contrast, if we are 'seeking assistance' from a KPMG Accredited Sampling Professional, we do not evidence this involvement.

What if we identify control deviations when we are performing dual-purpose testing? [ISA | 621.12130]

Refer to guidance in our sampling chapter discussing when we 'Determine the effect of control deviations'.

Examples

How does a control deviation affect the RAWTC? [ISA | 621.1700]

Fact pattern

When performing risk assessment procedures, the engagement team identifies an RMM related to revenue being recorded before it meets the revenue recognition criteria. In response, the team plans to test controls to support a lower combined assessed risk (CAR) for the identified RMM. The team designs and executes interim audit procedures at four months before period end to test controls A, B, and C, which address the process risk points related to the RMM.

The results of the procedures lead the team to conclude that Controls A and B are designed and operating effectively. However, they identify a deviation in Control C - a manual recurring control with

a RAWTC of Base - because the control operator had not executed the control in a manner consistent with its design.

When the team investigated the reason for the deviation, they determined that the deviation related to the first time the control was performed by a new control operator. The team had not previously identified this change in personnel or considered that change in their initial assessment of the RAWTC.

Analysis

The current control operator does not have the same experience or background as the former control operator. The team therefore re-evaluated the RAWTC and reassessed the risk as Elevated.

As a result of the re-assessed RAWTC of Control C, the team also considered modifying the nature, timing and extent of the procedures needed to test Control C for the remainder of the period. They also consider whether to change:

- the testing they already performed at interim over other controls,
- their testing to confirm it was an isolated incidence or a systemic issue,
- their evaluation of whether a control deficiency existed at interim and whether to re-assess control risk and CAR,
- their rollforward procedures for controls they concluded on at interim,
- their evaluation of the control environment and monitoring of controls.

2 Test automated process control activities throughout the period, if appropriate [ISA | 7612]

What do we do?

IF circumstances are appropriate THEN we may test the operating effectiveness of an automated process control activity at multiple points throughout the period

Why do we do this?

In certain circumstances and when we do not rely on relevant general IT controls (GITCs), we may test the automated process control activity at multiple points throughout the period to gain evidence that the Risk Arising from IT (RAFIT) has not affected the operating effectiveness of that control to enable us to continue to rely on that control.

Execute the audit

When may we test the operating effectiveness of automated process control activities at multiple points throughout the period? [ISA | 7612.12097]

We may test the operating effectiveness of automated process control activities at multiple points throughout the period when:

- we have not tested the operating effectiveness of the relevant GITCs; or
- where we have concluded that a relevant GITC is not operating effectively throughout the period under audit. However, this approach is only appropriate in limited circumstances.

Enhanced | When is it inappropriate to test automated process control activities at multiple points throughout the period? [ISA | 7612.12098]

We use our judgment when assessing whether it is appropriate to test automated process control activities throughout the period considering certain factors. The following table indicates circumstances when it is inappropriate to test an automated process control activity at multiple points throughout the period:

Factor	Circumstance indicates that the approach is inappropriate
Complexity of the IT environment	A complex IT environment or indications from our understanding of CERAMIC that the IT environment is inappropriately designed
Assessment of inherent risk for the risks of material misstatement (RMMs), especially fraud risks	The automated process control activity is intended to respond to a significant risk
Nature and frequency of the control	The automated process control activity is more complex or the frequency of operation of the automated process control activity is so high that our length of intervals for testing becomes very small
Frequency of changes to the relevant IT layers	Frequent changes to the relevant IT layers
Risk associated with the control (RAWTC)	RAWTC is assessed as significant or significant +
Significant deficiency in GITC	We identify a significant deficiency in a GITC related to the automated process control activity

When we apply this approach, we seek advice from an appropriate individual with expertise in IT as they may identify technical limitations that would undermine the testing using this approach.

Core and Less Complex | When is it inappropriate to test automated process control activities at multiple points throughout the period? [ISA | 7612.12099]

We use our judgment when assessing whether it is appropriate to test automated process control activities throughout the period considering certain factors. The following table indicates

circumstances when it is inappropriate to test an automated process control activity at multiple points throughout the period:

Factor	Circumstance indicates that the approach is inappropriate
Complexity of the IT environment	A complex IT environment or indications from our understanding of CERAMIC that the IT environment is inappropriately designed
Assessment of inherent risk for the risks of material misstatement (RMMs), especially fraud risks	The automated process control activity is intended to respond to a significant risk
Nature and frequency of the control	The automated process control activity is more complex or the frequency of operation of the automated process control activity is so high that our length of intervals for testing becomes very small
Frequency of changes to the relevant IT layers	Frequent changes to the relevant IT layers
Risk associated with the control (RAWTC) for the automated process control activity	RAWTC is assessed as significant or significant +
Significant deficiency in GITC	We identify a significant deficiency in a GITC related to the automated process control activity

In the first year that we test an automated process control activity throughout the period, we seek advice from an appropriate individual with expertise in IT as they may identify technical limitations that would undermine the testing using this approach. An appropriate individual with expertise in IT is also involved in a subsequent audit when there is a change in IT systems or IT personnel that impacts the operation of that automated process control activity.

How do we assess whether to use this approach? [ISA | 7612.6221]

We separately assess whether it is appropriate to use this approach and how to apply this approach, including seeking the advice of an appropriate individual with expertise in IT, for each automated process control activity that the approach may be relevant to. We cannot determine to take this approach at a layer, process or higher level.

What factors do we consider when determining the length of an interval when testing an automated process control activity at multiple points throughout the period? [ISA | 7612.12100]

The following table indicates the factors we consider and how they affect the length of the interval used when testing an automated process control activity at multiple points throughout the period:

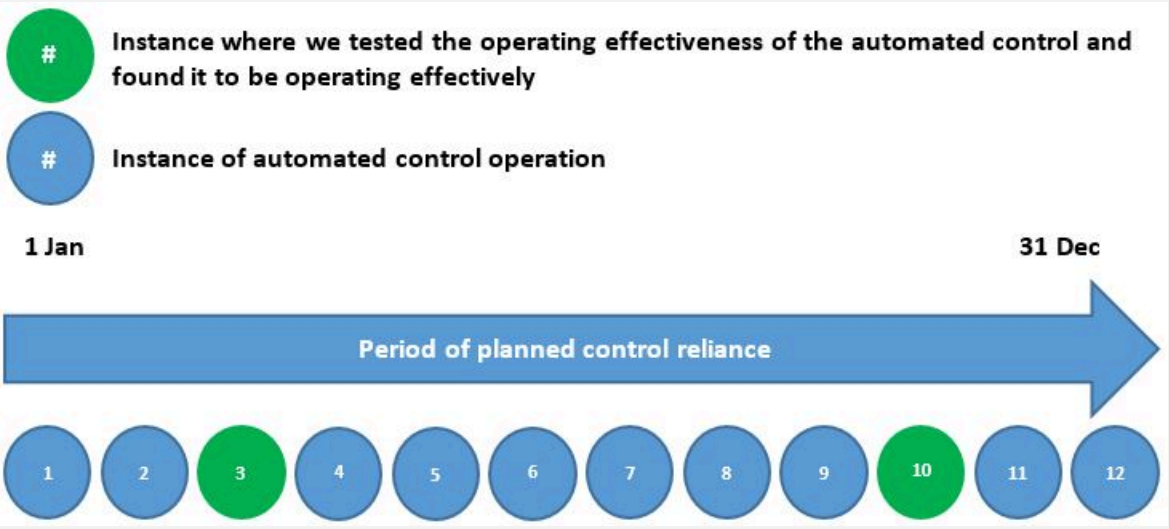
Factor	Impact
Complexity of the IT environment	The more complex the IT environment the shorter the intervals between controls.
Assessment of inherent risk for the RMMs, especially inherent risk of fraud	The higher the assessment of inherent risk the shorter the interval between controls.
Nature of the control	The more complex the automated process control activity, the shorter the intervals between controls.
Frequency of changes to the IT layers	The more frequently that there are changes to the relevant IT layers, the shorter the intervals
RAWTC	The higher the assessed RAWTC for the automated process control activity the shorter the intervals

The shortness of the intervals combined with the frequency of the control determines the number of times in the period we test the automated process control activity. For a recurring automated process control activity that operates separately over each individual transaction, the control operates multiple times per day, such that even long intervals may result in testing at a large number of points in the period. On the other hand for an automated process control activity that operates once a month, even a short interval may result in testing at a few points in the period.

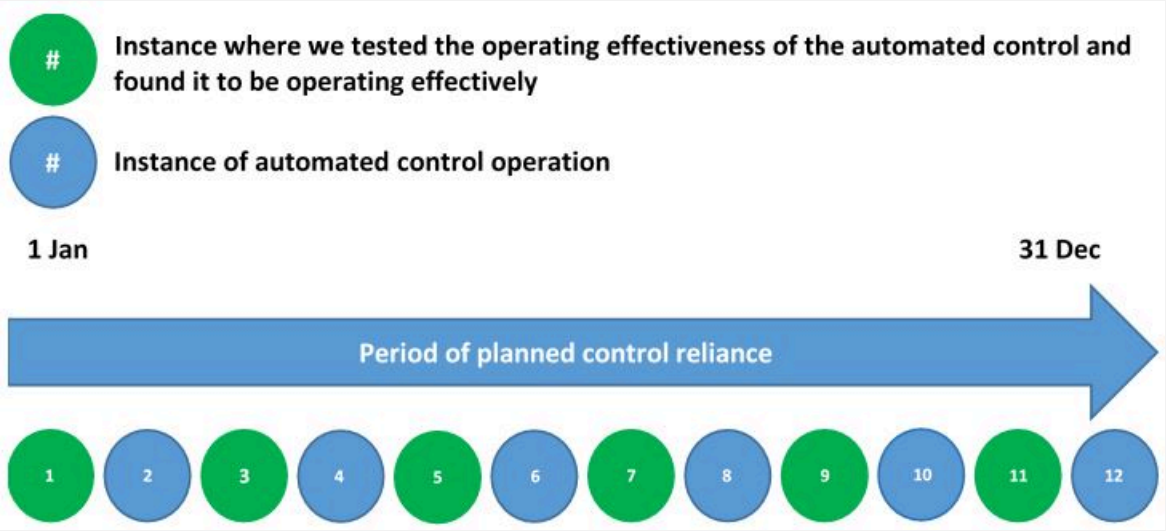
Why do we consider these factors to determine how frequently to test an automated process control activity at multiple points throughout the period? [ISA | 7612.12102]

We consider these factors to determine how frequently to test an automated process control activity at multiple points throughout the period because they are helpful in selecting the appropriate number of instances to test in order to obtain sufficient evidence over the consistent operation of the control.

For example, we have determined that it is appropriate to test a monthly automated process control activity at multiple points throughout the period based on our consideration of the relevant factors. We are testing the control within a non-complex IT environment, with no changes to IT layers. We determine to test 2 instances of the control.



However, if the IT environment is more complex and there are more frequent changes to IT layers, providing we have determined that this approach remains appropriate, our testing intervals become shorter and we test the automated process control activity more frequently.



Do we use the control sample size table to determine points in the period to test the automated process control activity? [ISA | 7612.12103]

No, we do not use the control sample size table for testing manual controls to determine points in the period to test the automated process control activity. These sample sizes are appropriate for manual controls only (see activity 'Determine the control sample size').

Instead we determine the number of instances to test through professional judgement factoring in the considerations in accordance with 'What factors do we consider when determining the length of an interval when testing an automated process control activity at multiple points throughout the period?' and combine that with the frequency of operation to determine the number of points in the period to test.

3 Conclude on our assessment of control risk [ISA | 1283]

What do we do?

Conclude on our assessment of control risk

Why do we do this?

We make a preliminary assessment of control risk as an input to our combined assessed risk (CAR) when planning our audit.

After performing procedures over the relevant controls, we either confirm or revise — i.e. reassess — our preliminary control risk assessment.

We confirm our preliminary assessment of control risk by considering all of the evidence we gather in evaluating the design and testing the operating effectiveness of relevant controls.

Execute the Audit

How do we assess control risk? [ISA | 1283.8519]

We assess control risk based on our understanding of controls and whether we plan to test the operating effectiveness of controls.

How do we make a preliminary assessment of control risk? [ISA | 1283.8522]

Our preliminary assessment of control risk is based on whether:

- we expect to rely on controls by testing the operating effectiveness of relevant controls to reduce our substantive procedures (Controls Reliance); or
- we will not rely on controls to reduce our substantive procedures (No Controls Reliance) because the controls are missing, we do not expect them to be effective or because we will not test their operating effectiveness.

Refer to activity 'Make a preliminary CAR assessment for each RMM' for additional information on the impact of our preliminary control risk assessment on CAR.

How do we conclude on our control risk assessment? [ISA | 1283.1400]

To conclude on our assessment of control risk:

- if we identified control deficiencies, we determine whether we can or want to test different controls that address the same RMM and process risk points,
- if we identified general IT control (GITC) deficiencies, we determine whether to test other GITCs or perform additional procedures,
- we evaluate the evidence we obtained from all sources, including our tests of controls, misstatements detected and any identified control deficiencies, and
- we confirm control risk assessment.

3.1 Respond appropriately to control deficiencies [ISA | 622]

What do we do?

IF we identify a control deficiency (or if management implement changes to controls), THEN respond appropriately.

Why do we do this?

The identification of control deficiencies may impact the assessment of control risk and therefore the combined assessed risk (CAR). As we design and perform substantive procedures that are responsive to CAR, we make these assessments by considering the identified control deficiencies appropriately.

Execute the Audit

Not Integrated | What if we identify a control deficiency(ies)? [ISA | 622.8516]

When we identify a deficiency(ies) in a process control activities, we may respond in one of three ways:

- identify a compensating control(s) that addresses the applicable process risk point (s) related to the RMM, and then evaluate its design and implementation and test its operating effectiveness;
- if there is a remediated control(s), evaluate its design and implementation and test its operating effectiveness; or
- if there are no compensating or remediated controls or we determine not to test these controls, we revise our control risk assessment for the related RMM to No Controls Reliance and modify our planned substantive procedures.

> For example, if we use sampling to test operating effectiveness of a control and conclude that the sample results do not support the planned assessed level of control risk for an assertion, we re-evaluate the nature, timing, and extent of substantive procedures based on a revised consideration of the assessed level of control risk for the relevant financial statement assertions.

If we are unable to obtain sufficient appropriate audit evidence from substantive procedures alone for the RMM, then we have a scope limitation for that RMM. We respond to scope limitations by performing procedures in accordance with 'Modify the audit opinion for specific circumstances'.

Regarding deficiencies in general IT controls (GITCs), refer to the activity 'In response to GITC deficiencies, test other GITCs, perform procedures or conclude on related automated control(s) and/or reliability of data within the IT system'.

What if management changes a process control activity we plan to rely on? [ISA | 622.1400]

If management changes the design of a process control activity we plan to rely on, we find out why. It some cases, it may be to remediate an identified deficiency by either putting different controls in place or by fixing the root cause of the deficient control. In other cases, it may be to enhance a control or to respond to changing conditions.

In these situations, we determine whether to:

- reevaluate the design and retest the operating effectiveness of the changed or newly initiated control(s); or
- revise our control risk assessment and modify our planned substantive procedures.

If we intend to rely on the superseded controls — i.e. the original controls prior to the change — for the period of time they operated, then we evaluate their design and test operating effectiveness.

What are compensating controls? [ISA | 622.6211]

Compensating controls are controls that address the same objective (e.g. process risk point(s) or risks arising from IT) as a deficient control and address the period of time that the control is deficient - i.e., until the deficient control is remediated.

Compensating controls may be:

- different controls that were already in place and operating throughout the period and cover the same objective (e.g. process risk points or risks arising from IT) as the deficient control - i.e. redundant or duplicative controls; or
- 'ad hoc' controls management puts in place on a timely basis to respond to the identified deficiency and determine whether the deficiency caused a material misstatement during the period.

Sometimes, an entity may have redundant or duplicative controls that address the same process risk point(s) for an RMM, or as part of remediating control deficiencies during the period, the remediation actions constitute ad-hoc controls that cover the period that the deficiency existed and provide management, from a control perspective, with sufficient information to determine no material misstatement existed in the period where the deficiency existed. The following may also help us determine an appropriate assessment of control risk:

Do management have reasonable assurance that the deficiency didn't cause a material misstatement?	Situation 1: A deficiency in the access termination control (an untimely removal of access at the time of termination) was identified during the monthly access review by the CIO. Immediately after the identification of the inappropriate system access, the access was removed and, management performed their own procedures and determined that the person(s) who had inappropriate access did not, in fact, use that access. The monthly review control serves as a compensating control for the deficient access termination control that allows us assess control risk as "Controls Reliance" for the entire period.
Do management have reasonable assurance that the deficiency didn't cause a material misstatement?	Situation 2: A bank reconciliation during the year was determined to not be performed timely, but subsequent to that instance the bank reconciliation was performed timely. The nature of the bank reconciliation control,

	which will determine the appropriateness of reconciling items from periods during and after the deficiency, is such that a control risk assessment of "Controls Reliance" for the entire period is appropriate. However, we keep in mind that the timeliness of bank reconciliations may undermine the reliability of monthly management accounts.
Do management have reasonable assurance that the deficiency didn't cause a material misstatement?	Situation 3: A deficiency was identified in a control that is designed to approve payment for returned goods, which was remediated during the period. Management doesn't think that there was a material misstatement in the period where the control was deficient, but has only performed a high-level trend analysis that shows a small fluctuation in payments for returns between the remediated and unremediated periods. Because there was not a process control activity performed by management at an appropriate level of precision, we are likely to assess control risk as "No Controls Reliance" for the period with a deficiency, and "Controls Reliance" for the period without a deficiency.

What if we intend to identify and test a compensating control over the same RMM and process risk point(s)? [ISA | 622.1600]

Before testing the compensating control, we first determine whether the compensating control is capable of achieving the same objective as the deficient control at the appropriate level of precision. If it is and we decide to test and rely on compensating controls, we evaluate their design and test operating effectiveness in the same manner as for any other control.

In some circumstances, a combination of controls may be necessary to compensate for one deficient control. In this case we test each of those controls.

If a compensating control is operating effectively, do we evaluate the original control as a deficiency? [ISA | 622.1700]

Yes. The presence of a compensating control doesn't change the fact that a deficiency existed in the original control, but it may mitigate the severity of that deficiency.

If we tested a compensating control, can we still assess control risk at Controls Reliance? [ISA | 622.1800]

Yes. If the compensating control addresses the applicable process risk point and is appropriately designed and operating effectively, we may still assess control risk at Controls Reliance - assuming all other applicable process risk points have been addressed.

What if management remediates a deficient control? [ISA | 622.1900]

We test remediated controls and compensating controls in the same way. If we intend to test and rely on a remediated control, we determine whether it is capable of addressing the same objective of the original control (e.g. all the process risk points the deficient control was intended to address at the appropriate level of precision). We then evaluate its design, implementation and test operating effectiveness.

When we determine RAWTC, we may also consider the fact that the remediated control has only recently been placed in operation. For example, we may increase RAWTC to Elevated or above if inherent risk was Base.

We also consider when the remediated control was placed into operation to determine the period of reliance and, if applicable, the impact on our ICFR opinion.

Finally, for process control activities, we assess control risk at Controls Reliance or No Controls Reliance for the period of reliance.

How does the timing of remediation impact our period of reliance in a financial statement audit only? [ISA | 622.2000]

When we test a remediated process control activity and conclude it is designed, implemented and operating effectively, that control reduces control risk for the duration of the period in which it is operating — i.e. from the time management implemented the remediated control.

> For example, assume we test a three-way match reconciliation control in July, and find it to be deficient. Management remediates the ineffective control, which then operates from August through December.
>
> If we test the remediated control and find it to be designed, implemented and operating effectively from August through December, we may rely on it to alter our substantive procedures for that portion of the period. The period August through December is then our period of reliance for that remediated control.

So, we may end up with two different control risk assessments over the same RMM for different portions of the audit period:

- before the remediated control was implemented — i.e. No Controls Reliance; and
- after the remediation — i.e. Controls Reliance.

If a remediated control is now operating effectively, do we evaluate the original control as a deficiency? [ISA | 622.2200]

Yes. Management's remediation of a control does not affect:

- our initial conclusion that the original control was deficient; or
- our responsibility to assess the severity of that deficiency.

Further, we assess the impact on our planned substantive procedures of both the deficiency and the results of our tests of the remediated control.

When we are not issuing a report over ICFR, why do we evaluate the deficiency? [ISA | 622.2600]

Even though we do not issue a report over ICFR in a financial statement audit, we still evaluate the deficiency so that we can:

- communicate it to management and those charged with governance (as needed);
- consider any impact on other controls; and
- consider the potential impact on our substantive procedures - i.e. changes in our assessment of control risk and CAR.

How do we evaluate the effect of a control deficiency on other controls? [ISA | 622.2800]

When we (or management) identify a control deficiency, we consider whether any other controls are affected so we can determine if additional deficiencies exist. Entities often have controls that rely on other controls - e.g. earlier in the process or in a separate process altogether. We therefore look at a control not only in isolation but also how it relates to the company's overall control objective.

> For example, suppose we test the operating effectiveness of a review control and we find it was designed and implemented appropriately and operating effectively. We later determine that a control activity over a report's completeness and accuracy was not operating effectively. We determine that this affects the review control we had concluded on, so we reassess whether the review control still operates effectively.

3.2 In response to GITC deficiencies, test other GITCs, perform procedures or conclude on related automated control(s) and/or reliability of data within the IT system [ISA | 7739]

What do we do?

IF we identify a deficiency in a general IT control, THEN test other general IT controls, perform additional procedures, or conclude that we cannot rely on the related automated control(s) and/or the related data within the IT system.

Why do we do this?

When we identify a deficiency in a general IT control (GITC) we planned to rely on, unless we respond to the deficient GITC, the consequence is that we can no longer rely on:

- the related automated control(s), when the GITC is supporting the effective operation of automated control(s), and/or

- the related data within the IT system, when the GITC is addressing the data integrity risk as part of evaluating the reliability of internal information used in the audit.

If we want to avoid this, we either test other GITCs that address the same risks arising from IT (RAFITs) or perform other procedures to gain evidence that the deficient GITC does not impact our planned audit procedures.

Execute the audit

What do we do when we identify a deficiency in a GITC we intended to rely on? [ISA | 7739.2500]

As part of concluding on our assessment of control risk for RMMs or evaluating the reliability of information used in the audit, when we identify a deficiency in a general IT control (GITC) we intended to rely on, we either:

- identify a compensating GITC that addresses the same risk(s) arising from IT (RAFIT(s)) for the applicable layer of technology as the ineffective GITC, and then evaluate its design and implementation and test its operating effectiveness;
- evaluate the design and implementation and test the operating effectiveness of the remediated GITC, if management remediates the deficient GITC;
- perform additional procedures to determine if the ineffective GITC impacted the consistent effective operation of the related automated control(s) and/or integrity of data within the IT system;
- obtain evidence that the automated control(s) related to the deficient GITC are not affected by testing them at multiple points throughout the period in order to still have control reliance for the period (see activity 'Test automated process control activities throughout the period, if appropriate' for further information). In this case, we are gaining evidence that identified RAFITs did not affect the effective operation of the automated process control activities, instead of relying on GITCs to address these risks; or
- conclude that we cannot rely on:
  - the related automated control(s), when the GITC supports the effective operation of automated control(s) (see question 'What if we identify a control deficiency when we plan to place reliance on a control?' for more information), and/or
  - the related data within the IT system, when the GITC addresses the data integrity risk as part of evaluating the reliability of internal information used in the audit (see activity 'If there are inconsistencies or doubts, modify or perform additional audit procedures and evaluate the effect on our audit' for more information).

For considerations related to evaluating the GITC deficiency refer to the activity 'Evaluate the severity of general IT control (GITC) deficiencies'.

What are compensating GITCs? [ISA | 7739.10986]

Compensating GITCs are GITCs that address the same RAFIT(s) and layers of technology as a deficient GITC and address the period of time that the GITC is deficient.

Compensating GITCs may be:

- different GITCs that were already in place and operating throughout the period and cover the same RAFIT(s) and layers of technology as the deficient GITC – i.e. redundant or duplicative GITCs; or
- 'ad hoc' GITCs management puts in place on a timely basis to respond to the identified deficiency (i.e. address the relevant RAFITs and layers of technology). The ad hoc GITCs are designed to determine if the ineffective GITC impacted the consistent effective operation of the related automated control(s) and/or integrity of data within the IT system.

What if we intend to identify and test a compensating GITC? [ISA | 7739.6326]

Before testing the compensating GITC, we first determine whether the compensating GITC is:

- addressing the same RAFIT(s) and IT layer(s) for at least the same period of time that the GITC is deficient, and
- capable of achieving the same objective as the deficient GITC.

If it is and we decide to test and rely on the compensating GITC, we evaluate its design and implementation and test its operating effectiveness in the same manner as for any other GITC.

In some circumstances, a combination of GITCs may be necessary to compensate for one deficient GITC. In this case we test each of those compensating GITCs.

What if we test a compensating GITC and it is operating effectively? [ISA | 7739.6327]

If we test a compensating GITC and is operating effectively, we:

- may conclude that the related automated control(s) are effective and/or the related data within the IT system is reliable, assuming the results of all other procedures performed to test such control(s) and/or evaluate the reliability of the information are satisfactory;
- still evaluate the original GITC as a deficiency. The presence of an effective compensating GITC doesn't change the fact that a deficiency exists in the original GITC, but it may mitigate the severity of that deficiency. Refer to the activity 'Evaluate the severity of general IT control (GITC) deficiencies' for more information.

What if we intend to test a remediated GITC? [ISA | 7739.6328]

If management remediates a deficient GITC and we intend to test and rely on the remediated GITC, we determine whether it is capable of addressing all the RAFIT(s) and IT layer(s) the deficient GITC was intended to address. We then evaluate its design and implementation, and test its operating effectiveness.

When we determine RAWTC, we may also consider the fact that the remediated GITC has only recently been placed in operation. For example, we may increase RAWTC to Elevated or above if RAWTC for the deficient GITC was Base.

What if we test a remediated GITC and it is operating effectively? [ISA | 7739.6329]

When we test a remediated GITC and conclude it is designed, implemented and operating effectively:

- the remediated GITC supports the effective operation of the related automated control(s) and/or addresses the data integrity risk of information within the IT system for the duration of the period in which it is operating — i.e. from the time management implemented the remediated GITC. Therefore, we may end up with two different conclusions regarding the operating effectiveness of

the related automated control(s) and /or reliability of related information within the IT system for different portions of the audit period, i.e. before and after the remediated GITC was implemented.

- We still evaluate the original GITC as a deficiency. Management's remediation of a control does not affect our initial conclusion that the original GITC was deficient, or our responsibility to assess the severity of that deficiency. Refer to the activity 'Evaluate the severity of general IT control (GITC) deficiencies' for more information.

What if we perform additional procedures to determine if the ineffective GITC impacted the related automated control(s) and/or integrity of data within the IT system? [ISA | 7739.6331]

In response to a GITC deficiency, instead of or in addition to testing one or more compensating GITCs and/or the remediated GITC (either because we haven't identified any or because we decide not to test them), we may perform additional procedures to obtain evidence that the deficient GITC did not impact RAFIT(s) and IT layer(s) that the GITC was designed to address during the period.

These additional procedures may provide evidence that allows us to continue to rely on the related automated control(s) and/or integrity of data within the IT system in our financial statement audit. However, they do not eliminate the GITC deficiency or impact our evaluation of its severity.

> For example, suppose we test GITCs related to application access and we identify that application developers have inappropriate access to promote changes directly into the live environment. This is inconsistent with their job responsibilities.
>
> We may then obtain evidence to determine whether the application developers:
>
> - made any changes to the application; or
> - used their inappropriate access to promote any changes that may impact the automated controls.
>
> For example, we may inspect reliable application change logs for the period where the inappropriate access existed to determine whether any changes were made by the inappropriate users. If no changes were made, then we may be able to continue to rely on the related automated control(s). However, these additional audit procedures do not eliminate the GITC deficiency.

The entity's management may decide to perform these additional procedures, in which case we consider them as an ad hoc compensating GITC which we may decide to test.

Under what circumstances do we conclude that a deficient GITC leads to not relying on the related automated control(s) and/or the related data within the IT system? [ISA | 7739.6379]

If we identify a deficiency in a GITC that addresses certain RAFIT(s) and IT layer(s) and we cannot obtain evidence that (1) the same RAFIT(s) and IT layer(s) have been addressed by other GITCs or (2) that the deficient GITC did not impact those RAFIT(s) and IT layer(s) during the period or (3) the automated control(s) related to the deficient GITC are not affected by testing them at multiple points throughout the period, then we can no longer rely on:

- the related automated control(s), when the GITC is supporting the effective operation of automated control(s), and/or

- the related data within the IT system, when the GITC is addressing the data integrity risk as part of evaluating the reliability of internal information used in the audit.

Examples of situations where we cannot obtain such evidence are:

- we don't test other GITCs (compensating and/or remediated), either because we haven't identified any or because we decide not to test them
- we test other GITCs (compensating and/or remediated) and one or more are not operating effectively
- the results of additional procedures performed show that the deficient GITC impacted during the period the consistent effective operation of the related automated control(s) and/or integrity of data within the IT system
- we test the automated control(s) related to the deficient GITC at multiple points throughout the period and we identify a deficiency.

3.3 Evaluate all evidence when assessing control risk [ISA | 623]

What do we do?

Evaluate the evidence obtained from all sources, including tests of controls, misstatements detected and any other identified control deficiencies, when assessing control risk for each risk of material misstatement.

Why do we do this?

When we test the operating effectiveness of relevant controls and assess control risk, we evaluate evidence obtained from all sources. We may have tested controls and determined them to be operating effectively, but we do not ignore other evidence that suggests controls aren't effective. If we do, we may inappropriately place reliance on ineffective controls.

Execute the Audit

What other sources do we consider when we assess control risk? [ISA | 623.1300]

Other sources we consider in assessing control risk include:

- testing of other controls and any identified control deficiencies;
- any misstatements identified in the financial statements, which may indicate the control was deficient;
- control evidence obtained through reading internal audit reports, whether or not those reports were prepared to report on results of tests of controls;
- the results of inquiries and any other procedures we perform around all parts of the business through any phase of the audit; and
- the results of tests of controls performed for the audit of internal control over financial report (if applicable).

If we cannot obtain evidence that a control actually operates, then it is unlikely we may gather sufficient evidence of the control's effective operation to allow us to assess control risk as Controls Reliance.

Do we consider the results of our substantive procedures when we test the operating effectiveness of a control? [ISA | 623.1500]

When we assess control risk, we consider evidence obtained from all sources, including the results of our substantive procedures. The most direct source will be the operating effectiveness of all controls related to the relevant assertion.

However, even when we determine that controls are operating effectively, we cannot ignore other evidence that a control may not be working. So if we identify a misstatement when performing substantive procedures, we next determine whether a control is deficient and whether we planned to rely on that control. When we detect a misstatement through our substantive procedures, it is often the result of a control deficiency.

What if the misstatement is below our posting threshold or management corrects the misstatement? [ISA | 623.10997]

We can't ignore a misstatement, even if it is below our audit misstatement posting threshold (AMPT) or management corrects it. Instead, we determine whether a control we relied on was deficient, and whether the misstatement was due to the control deficiency.

A control may not be designed to operate at the same level of precision as our substantive procedure. If the level of precision for the control is appropriate, we may be able to conclude that the control is operating effectively (assuming no other factors) even when a misstatement occurred. But if the misstatement exceeds the level of precision, we determine whether the control is operating effectively and reassess control risk.

How does a control deficiency affect our assessment of control risk? [ISA | 623.1700]

When we identify a control deficiency, we assess control risk as No Controls Reliance, unless we have identified and tested a compensating control that addresses the same applicable process risk point. This is the case if the control deficiency is due to the control not being designed and implemented appropriately or because it is not operating effectively.

Our assessment of control risk is binary: Controls Reliance or No Controls Reliance. The relevant controls addressing the applicable process risk points for an RMM are either adequately designed and operating effectively, or they are not. We have either gathered sufficient, appropriate audit evidence about the effectiveness of controls, or we have not. We do not evaluate control risk on a sliding scale. We make our assessment at the level of the risk of material misstatement (RMM) and not at the individual control level.

If an applicable process risk point related to an RMM is not addressed by a properly designed and effective control, then there is an unaddressed risk that the company's controls may not prevent or detect and correct a material misstatement. We therefore do not assess control risk as Controls Reliance for the entire RMM.

Examples

How may evidence from other sources affect our assessment of control risk? [ISA | 623.1800]

Fact pattern

An engagement team plans to test and rely on controls to alter their substantive procedures to address the RMM related to out-of-period recognition of sales and accounts receivable - i.e. revenue cut-off. The team designs and executes procedures to test controls that address each process risk point related to the identified RMM. The results lead the team to conclude that the evaluated controls were designed, implemented and tested controls were operating effectively over the full period of reliance.

However, when the team performs substantive procedures over the same RMM, they identify a misstatement in accounts receivable that relates to overstatement of certain customer receivables.

Analysis

The team has identified a misstatement, so one or more controls may have failed to prevent or detect and correct the misstatement in a timely manner. Even though the engagement team tested controls and found them to be operating effectively, information from our substantive procedures provides an indication that one or more controls were not properly designed or operating effectively. If found deficient, the team cannot place reliance on those controls to alter their substantive procedures for that particular RMM.

3.4 Confirm control risk assessment [ISA | 624]

What do we do?

Confirm control risk at Controls Reliance or No Controls Reliance

Why do we do this?

Although we made a preliminary CAR assessment, we now determine if any changes are necessary after testing the operating effectiveness of the controls we intended to rely on and assessing control risk. We assess control risk at Controls Reliance or No Controls Reliance to determine our combined assessed risk (CAR), which we use to determine the nature, timing and extent of our substantive procedures.

Execute the Audit

How do we assess control risk? [ISA | 624.1400]

We assess control risk for each RMM.

Our assessment of control risk is binary: Controls Reliance or No Controls Reliance. We either have evidence that the controls addressing the RMM are adequately designed and operating effectively, or we do not. We have either gathered sufficient, appropriate audit evidence about the effectiveness of controls, or we have not. We do not evaluate control risk on a sliding scale.

We do not weigh the severity of deficiencies against one another in assessing control risk. When we assess control risk at Controls Reliance, each process risk point associated with an RMM is addressed by a properly designed and effective control. If not, there is an unaddressed risk that the entity's controls may not prevent or detect a material misstatement, and control risk is therefore No Controls Reliance for that particular RMM.

Remember, process risk points are those points within the entity's process at which a material misstatement may arise, either individually or in combination with other misstatements.

How do we determine whether to assess control risk at either Controls Reliance or No Controls Reliance? [ISA | 624.1500]

We assess control risk at Controls Reliance when we have sufficient evidence of the operating effectiveness of the related controls over each applicable process risk point related to an RMM. We consider all of the audit evidence we have obtained, including:

- identifying process risk points in the business process;
- testing the design of the control by evaluating whether controls and control attributes are designed to address all control objectives — i.e. applicable process risk points — and operate at the right level of precision;
- testing the implementation of the control;
- testing the operating effectiveness of the control, where the nature, timing and extent of our procedures respond to the risk associated with the control;
- considering evidence from other procedures — including substantive audit procedures — and any misstatements detected; and
- considering control deficiencies identified in other areas that may impact our control risk assessment — e.g. in Control Environment, Risk Assessment, Monitoring or Information and Communication (CERAMIC).

We assess control risk at No Controls Reliance when:

- we have evidence that management's controls are not properly designed or not operating effectively; or
- we don't have enough evidence to conclude on the controls - including when we have chosen not to rely on controls to alter our substantive procedures.

What if final assessed control risk is different from the initial planned control risk? [ISA | 624.1600]

If our final assessed control risk disconfirms our initial planned control risk, we use that final assessment to reassess CAR.

Our initial planned control risk enables us to begin (or plan) our interim substantive testing before our tests of controls are complete. We estimated initial planned control risk in order to determine a preliminary CAR. When our control risk has changed, we determine the impact on our planned audit approach.

Change in control risk	Impact
Control risk has gone from Controls Reliance to No Controls Reliance	We change our CAR assessment for the affected period, and modify the nature, timing and extent of both planned and performed substantive procedures — e.g. by increasing our substantive sample sizes.

Control risk has remained the same	No changes are necessary to our CAR assessment as a result of control risk.
Control risk has gone from No Controls Reliance to Controls Reliance	We may have performed too much substantive testing. We do not revise the procedures already performed or remove them from our file. We consider the evidence obtained and adjust the planned substantive procedures that have not yet been performed, as necessary.

Can we have Controls Reliance on controls for only part of the period? [ISA | 624.1700]

Yes. It is possible to have Controls Reliance for part of the period under audit, and No Controls Reliance for the rest of the period. This can occur when:

- we've identified a deficiency;
- no compensating controls were in place before and up to the deficiency; and
- controls are remediated prospectively at a point in time.

We may know from our risk assessment procedures that controls are not in place and operating effectively for the entire period. As such, we may plan our audit such that the period of reliance is less than the entire period. If we evaluate the design and test the operating effectiveness of controls for that shorter period of reliance, then control risk can be Controls Reliance for that period and No Controls Reliance for the rest of the period.

When that happens, we will also have different CAR assessments — BC/EC/SC for the period where control risk is Controls Reliance, and BN/EN/SN for the period where control risk is No Controls Reliance depending on the level of the inherent risk of the RMM.

Examples

When might we assess control risk at No Controls Reliance? [ISA | 624.2000]

The table below sets out examples of situations where we may assess control risk at No Controls Reliance.

Situation where we assess control risk at No Controls Reliance	Examples
Controls necessary to sufficiently address an RMM are missing or ineffective	• We determine that controls are not in place to address all process risk points related to an RMM (i.e., controls are missing). • We evaluate the design, implementation and/or test operating effectiveness of controls and conclude that they are not effective in addressing all the process risk points related to an

	RMM (i.e., controls are either not designed and implemented effectively or not operating effectively).
We have not obtained sufficient appropriate evidence to support a control risk assessment at Controls Reliance	• We elect not to test and rely on controls to reduce control risk. • We find that controls are effectively designed and implemented, but we choose not to test their operating effectiveness — e.g. for a significant risk where we evaluate the design and implementation of controls. • Due to the nature of the RMM, tests of controls provide insufficient evidence to alter our substantive procedures.

Substantive Procedures

International Standards on Auditing: ISA 330.18-19

Substantive Procedures

18. Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. (Ref: Para. A43-A49)

19. The auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures. (Ref: Para. A50-A53)

ISA Application and Other Explanatory Material: ISA 330.A43-A53

Substantive Procedures (Ref: Para. 18)

A43. Paragraph 18 requires the auditor to design and perform substantive procedures for each material class of transactions, account balance, and disclosure. 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. 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 in accordance with ISA 315 (Revised 2019).[111]
- This requirement reflects the facts that: (a) the auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and (b) there are inherent limitations to controls, including management override.

111 ISA 315 (Revised 2019), paragraph 36

A44. 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.

Nature and Extent of Substantive Procedures

A45. Depending on the circumstances, the auditor may determine that:

- Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.
- Only tests of details are appropriate.
- A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

A46. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. ISA 520[5] establishes requirements and provides guidance on the application of analytical procedures during an audit.

5 ISA 520, *Analytical Procedures*

A47. The assessment of the risk or the nature of the assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included.

A48. Because the assessment of the risk of material misstatement takes account of controls that the auditor plans to test, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk.

A49. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing. See ISA 500.[6]

6 ISA 500, *Audit Evidence*, paragraph 10

Considering Whether External Confirmation Procedures Are to Be Performed (Ref: Para. 19)

A50. External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions

between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no "side agreement" exists that may be relevant to an entity's revenue cutoff assertion. Other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include:

- Bank balances and other information relevant to banking relationships.
- Accounts receivable balances and terms.
- Inventories held by third parties at bonded warehouses for processing or on consignment.
- Property title deeds held by lawyers or financiers for safe custody or as security.
- Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- Accounts payable balances and terms.

A51. Although external confirmations may provide relevant audit evidence relating to certain assertions, there are some assertions for which external confirmations provide less relevant audit evidence. For example, external confirmations provide less relevant audit evidence relating to the recoverability of accounts receivable balances, than they do of their existence.

A52. The auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for bank balances often include requests for information relevant to other financial statement assertions. Such considerations may influence the auditor's decision about whether to perform external confirmation procedures.

A53. Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

- The confirming party's knowledge of the subject matter - responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- The ability or willingness of the intended confirming party to respond - for example, the confirming party:
    - May not accept responsibility for responding to a confirmation request;
    - May consider responding too costly or time consuming;
    - May have concerns about the potential legal liability resulting from responding;
    - May account for transactions in different currencies; or
    - May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

- The objectivity of the intended confirming party - if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Design and perform substantive procedures for accounts and disclosures with no RMMs [ISA | 1304]

What do we do?

IF we have a material account balances with no RMMs THEN design and perform substantive procedures

Why do we do this?

The standards contemplate that our assessment of risk is judgmental and may not identify all risks of material misstatement, as well as the fact that there are inherent limitations to internal control. To respond to this, we perform substantive procedures over material non-significant accounts (MNSAs).

Execute the Audit

What is a material non-significant account (MNSA)? [ISA | 1304.1400]

A material non-significant account is a material class of transactions, account balances or disclosures that contain **NO** RMMs.

Material accounts are those that are equal to or greater than materiality.

What substantive procedures do we perform for a material non-significant accounts (MNSAs)? [ISA | 1304.1500]

When designing substantive procedures for MNSAs, we keep in mind that the objective of these procedures differs from those that are responsive to an identified RMM for a significant account. The objective of these procedures is to respond to the risk that the assessment we made that the risk of material misstatement is remote is in fact incorrect. As a result, they may be less precise.

In some cases, we may have already performed substantive procedures related to material non-significant accounts that provide us sufficient evidence over the MNSA.

Source of audit evidence	Relevant guidance
Planning analytical procedures or final analytical procedure	Planning analytical procedures and final analytical procedures are not designed with the objective of providing substantive audit evidence. However, if such procedures are performed and documented with an expectation and are at the appropriate level of precision, we may use these procedures to provide substantive audit evidence for MNSAs.
Evidence obtained from previous audits with continuing relevance in the current period	In most cases, audit evidence from a previous audit's substantive procedures provides little or no audit evidence for the current period. However, there are exceptions if: • That evidence and the related subject matter have not fundamentally changed from the previous audit, and

	• Audit procedures have been performed during the current period to establish the continuing relevance of the evidence obtained from previous audits. The procedures in the current period to establish continuing relevance of the evidence obtained from previous audits may not be incremental but may already be performed as part of our audit, such as inspection of minutes of meetings of those charged with governance, understanding obtained of CERAMIC, and audit procedures performed on the financial reporting process. For example, if we audited the acquisition of a building in a previous period and our risk assessment procedures and other substantive procedures (including inspection of minutes of meetings of those charged with governance, not identifying indications of impairment from risk assessment and substantive procedures, no deficiencies identified in CERAMIC), do not identify additions to the building or impairment to the recorded amount of the building, it may be appropriate to consider the substantive evidence obtained in the current period regarding the continuing relevance of the previous period's findings as being sufficient.
Evidence obtained from substantive procedures performed on a related account	If audit evidence has been obtained from substantive procedure(s) on a related significant account that also provides some substantive audit evidence related to this non-significant account, we can take credit for such procedure(s) if we document how they provide evidence related to the non-significant account.
Data analysis	Example procedures may include: • obtaining the detail of the account balance that reconciles to the general ledger balance; • analyzing the detail for unusual items that are inconsistent with our understanding of the entity and the nature of the account; • obtaining audit evidence related to identified unusual items. The level of precision for a substantive analytical procedure performed for MNSAs may be lower than that performed for a significant account.
Other substantive analytical procedures	A substantive analytical procedure may be an effective and efficient test for MNSAs as complex disaggregation may not be necessary for these accounts.

	The level of precision for a substantive analytical procedure performed on for MNSAs may be lower than that performed for a significant account.
Judgmental selection of items to test	Such a procedure may include: • obtaining the detail of the account balance that reconciles to the general ledger balance; • selecting a judgmental selection of items that is appropriate for the test; For example, selecting 5 items in a haphazard manner. • obtaining audit evidence related to selected items.

What if there is a material financial statements caption where we have no planned substantive procedures? [ISA | 1304.11427]

When there is a financial statements caption that:

- is equal to or greater than materiality, and
- has no significant accounts or MNSAs identified

we design and perform substantive procedures over some portion of the caption similar to other MNSAs.

> For example, suppose an entity has a financial statement caption for prepaid expenses that is 1.5x materiality and the caption is broken down into 3 accounts, prepaid insurance, prepaid rent and deposits for utilities, which each are approximately 0.5x materiality. The engagement team has not identified any RMMs related to these accounts, thus has not identified any as significant accounts. In addition, because none of the accounts exceed materiality, they are also not MNSAs.
>
> Since the prepaid expenses caption exceeds materiality, the engagement team designs at least one substantive procedure over prepaid insurance, prepaid rent and/or deposits for utilities.

How do we evaluate the reliability of information used in our substantive procedures performed over MNSAs? [ISA | 1304.6425]

As the objective of a substantive procedure over MNSAs is different from, and may be less precise, than that performed to address an RMM, the way we evaluate the reliability of information used in such a procedure may also differ. Our evaluation of the reliability of any information used in substantive procedures performed over MNSAs may be likened to that performed over information used in risk assessment and we refer to "how do we evaluate the reliability of information used in our risk assessment procedures" to determine the extent of procedures to perform.

2 Determine whether to perform external confirmation procedures [ISA | 3887]

What do we do?

Determine whether to perform external confirmation procedures as substantive audit procedures

Why do we do this?

External confirmation procedures (confirmation procedures) can be an effective way to obtain audit evidence for certain types of balances because we receive information directly from a third party. We consider what we learned during risk assessment to help us determine whether confirmation procedures are appropriate substantive procedures to address risks of material misstatement.

Execute the Audit

What is a confirmation? [ISA | 3887.1300]

A confirmation is the process of obtaining and evaluating a direct written response to us from an external third party in response to a request for information about a particular item affecting financial statement assertions. A confirmation may be in paper form, or by electronic or other medium (e.g. through our direct access to information held by a third party).

How do we use confirmations? [ISA | 3887.14987]

Confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. We may also use confirmation procedures to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a "side agreement."

For example, we may use confirmations in relation to testing the relevant RMMs related to:

- Bank balances;
- Accounts receivable balances and terms;
- Inventories held by third parties at bonded warehouses for processing or on consignment;
- Property title deeds held by lawyers or financiers for safe custody or as security;
- Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date;
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants;
- Accounts payable balances and terms;
- Guarantees;
- Contingent liabilities;
- Significant transactions outside the normal course of business; and/or
- Related party transactions and relationships.

How do we determine whether to perform confirmation procedures? [ISA | 3887.1500]

To determine whether we perform confirmation procedures, we:

- Assess whether to perform confirmations in conjunction with other procedures ;
- Consider confirming the terms of unusual or complex transactions ;

2.1 Assess whether to perform confirmations in conjunction with other procedures [ISA | 3888]

What do we do?

Assess whether confirmation procedures as a substantive procedure will be performed rather than or in conjunction with other tests

Why do we do this?

When determining whether to perform confirmation procedures, we assess whether the evidence provided by confirmation procedures alone reduces audit risk for the related risks of material misstatement (RMMs) to an acceptably low level or whether confirmation procedures in conjunction with other procedures performed will reduce audit risk to an acceptably low level.

Execute the Audit

What do we consider when determining whether to perform confirmation procedures? [ISA | 3888.1300]

In determining whether to send confirmations, we consider the combined assessed risk (CAR) of the RMM being addressed. When we assess inherent risk as Elevated or Significant and control risk as No Controls Reliance, we seek more persuasive evidence. Sending confirmations may provide more persuasive audit evidence because we are getting evidence directly form a third party. For additional considerations see activity 'Design and perform substantive procedures for each RMM'.

We also think about the efficiency of sending them as compared to alternative procedures that may be performed to address the RMMs and to reduce audit risk to an acceptably low level.

How do we assess whether to perform other procedures in conjunction with confirmations? [ISA | 3888.15213]

When assessing whether to perform other procedures in conjunction with confirmations we consider:

- whether audit evidence we expect to obtain from the confirmations will be sufficient and appropriate to reduce audit risk to an acceptably low level.
- the materiality of the account balance - as the size of the account balance increases, so does the extent of audit evidence necessary.
- The appropriateness of the audit evidence obtained from confirmations. For audit evidence to be appropriate it has to be relevant and reliable in response to the identified assertion-level RMMs.
- The relevant CAR assessment for the RMM.

What assertions may sending confirmations address? [ISA | 3888.15019]

Confirmations can be a good way to respond to certain RMMs, particularly as they relate to the following assertions:

Assertion	Evidence Provided by Confirmation Procedures

Completeness	*Less relevant as it is harder to confirm items that do not exist in the accounts*
Existence	Assets or liabilities of the company exist at a given date, and recorded transactions have occurred during a given period
Accuracy	Amount recorded and/or disclosed is correct and properly classified or allocated to the proper account
Valuation	*Less relevant as this often involves subjectivity and judgement*
Obligation	The entity: • holds or controls the rights to assets; • has obligations associated with liabilities and equity interests; and • has the rights and obligations to transactions and events that it has recorded (i.e. transactions and events pertain to the entity)
Presentation	The transactions and events, balances or other matters disclosed in the financial statements: • have occurred and/or are relevant to the accounting period, • pertain to the entity, and • properly disclose the amounts and terms and conditions (i.e. are appropriately measured and described).

When do we perform confirmation procedures for cash and cash equivalents? [ISA | 3888.7935]

When an RMM over the existence of cash and cash equivalents has been assessed, for each of an entity's 'main' bank accounts and bank accounts with a year-end general ledger balance that is, or is expected to be, greater than performance materiality (PM), we request third party confirmations at (or close to) year-end.

An engagement team's rationale for the rebuttal of the procedure is documented in the workpapers and reviewed by an engagement partner or other audit partner on the engagement

What are an entity's 'main' bank accounts? [ISA | 3888.7936]

An entity's 'main' bank accounts are those relating to the general ledger accounts that are used to track the cash activities associated with an entity's primary sources of cash inflow and outflow. Primary sources of cash inflows may be those generated from its revenue transactions or others such as from loan arrangements. Primary sources of cash outflows may be those generated from its operating expenditures (e.g. payroll and accounts payable) or others such as from repayments of debt. These bank accounts may or may not have a balance at year-end if designed as a zero-balance account with

sweep arrangements. Bank accounts that are periodically funded by a 'main' bank account and used solely as a pass-through bank account to pay out periodic expenses of the entity, for example monthly payroll, could be determined not to be a 'main' bank account. An entity may also have multiple 'main' bank accounts depending upon its size and structure of its organization or treasury function.

Why do we request third party confirmations for an entity's 'main' bank accounts? [ISA | 3888.7937]

We request third party confirmations for an entity's 'main' bank accounts primarily to respond to the risk over the existence of cash and cash equivalents.

How do we identify an entity's 'main' bank accounts? [ISA | 3888.7938]

We identify an entity's 'main' bank accounts as part of our risk assessment over the cash management or treasury process. See the chapter on identifying and assessing risks of material misstatementfor additional considerations.

What other substantive procedures do we perform? [ISA | 3888.7939]

When an RMM over the existence or classification of cash and cash equivalents has been assessed, in addition to requesting third party confirmations at (or close to) year-end, for each of an entity's 'main' accounts and accounts with a year-end general ledger balance that is, or is expected to be, greater than PM, we perform the following procedures:

- When requesting third party confirmations for bank accounts at a date close to year-end, substantively test the related bank reconciliation at the date close to year-end and perform appropriate additional procedures through the year-end date;
- Perform substantive audit procedures over the entity's year-end bank reconciliation(s); and
- Assess whether the classification of cash and cash equivalents is appropriate under the applicable financial reporting framework, particularly if cash is restricted or held as collateral, or if an entity holds cash equivalents.

An engagement team's rationale for the rebuttal of any of these procedures is documented in the work papers and reviewed by an engagement partner or other audit partner on the engagement.

What substantive procedures do we perform over the entity's year-end bank reconciliation(s)? [ISA | 3888.7940]

We perform the following procedures, at a minimum:

- Trace the cash or cash equivalent balance on the bank reconciliation to the bank confirmation obtained;
- Trace the general ledger balance on the bank reconciliation to the general ledger;
- Select reconciling items for testing based on an understanding of the expected types of reconciling items, aged items and/or unusual items. The selection of reconciling items is considered on a gross basis rather than on a net basis (i.e., outstanding deposits and outstanding checks are selected separately); and
- Trace the selected reconciling items to relevant source documentation and assess them for appropriateness and timely resolution (i.e., verify adjustments to the general ledger are recorded, if necessary). Solely determining that the reconciling items cleared in a subsequent reconciliation does not provide sufficient evidence.

When taking a dual-purpose approach in testing bank reconciliations, once the design of the control is determined to be effective, the testing procedures are designed and performed to meet both the substantive and control testing objectives.

For example, if the entity's control over the bank reconciliation is designed to include the review of all reconciling items, the substantive testing procedures are performed on the same population of reconciling items used to test the control.

What does 'close to year-end' mean for purposes of third party bank confirmations? [ISA | 3888.7941]

A date 'close to year-end' for purposes of third party bank confirmations means a date no earlier than two months prior to the balance sheet date (e.g. October 31, 202X for a December 31, 202X calendar year-end entity), determined by the engagement team based on its risk assessment and corresponding planned audit response.

What procedures do we perform when we request third party confirmations at a date close to year-end? [ISA | 3888.7942]

What procedures do we perform when we request third party confirmations at a date close to year-end?

When requesting third party confirmations at a date close to year-end, in addition to substantively testing the bank reconciliations at the date close to year-end and the bank reconciliation as of the year-end date, we also perform appropriate additional procedures through the year-end date, which may include:

- Obtaining evidence that the year-end bank statement is reliable, for example, we may observe management access the bank account statement online by observing management conducting an internet search from their computer to verify they are accessing the internet and then observing them enter the bank's URL; and
- Inquiring of management as to whether there have been any new bank accounts opened or any new financial instruments acquired or guarantees entered during the intervening period that could change the assessed risk over cash and cash equivalents. Management responses may be corroborated through:
- inspection of other documentation from the financial institution, including review of bank statements for any fees paid in relation to guarantees; and
- scanning bank statements for significant transfers of cash to new or unknown accounts, especially around the balance sheet date.

Does the group auditor plan substantive procedures over 'main' bank accounts and bank accounts with year-end balances at components that are greater than or expected to be greater than group PM? [ISA | 3888.7943]

When there is an RMM related to the existence of cash and cash equivalents in the group financial statements at a component, the group auditor or component auditor plans substantive procedures at the component over:

- 'main' bank accounts and
- bank accounts with year-end balances that are greater than group PM.

What else do we think about when determining whether to perform confirmations as a substantive procedure? [ISA | 3888.15217]

The table below indicates factors that may assist us in determining whether to perform confirmations as a substantive procedure:

Factor	What we think about
The confirming party's knowledge of the subject matter	Responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information in the confirmation.
The ability or willingness of the intended confirming party to respond	The confirming party: • May not accept responsibility for responding to a confirmation request • May consider responding too costly or time consuming • May have concerns about the potential legal liability resulting from responding • May account for transactions in different currencies, or • May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations In such circumstances, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response. Circumstances may exist where it may be difficult to obtain responses to confirmation requests or all the information requested and, therefore, we may plan alternative or additional procedures.
The independence and objectivity of the intended confirming party	If the confirming party is a related party of the entity, responses to confirmation requests may be less reliable and may not provide sufficiently persuasive audit evidence.

What is audit risk? [ISA | 3888.1400]

Audit risk is the risk that we express an inappropriate audit opinion when the financial statements are materially misstated i.e., the financial statements are not presented fairly in conformity with the applicable financial reporting framework (see activity 'Evaluate whether the financial statements are presented fairly').

Audit risk is made up of two components:

- Risks of material misstatement (RMM), which we assess in accordance with the chapter on 'Identifying and assessing risks of material misstatement' (ISA 315, AU-C 315, AS 2110); and

- Detection risk.

How does obtaining sufficient appropriate audit evidence affect risk? [ISA | 3888.1401]

Obtaining sufficient appropriate audit evidence reduces audit risk (see question 'What is audit risk?').

Audit risk consists of combined assessed risk (CAR) (see question 'What is combined assessed risk?'), the combination of inherent risk and control risk, and detection risk. We obtain more persuasive evidence as CAR increases.

What influences the persuasiveness of audit evidence? [ISA | 3888.1500]

The following diagram illustrates the factors that influence the persuasiveness of audit evidence:

How persuasive will the evidence provided by sending confirmations be? [ISA | 3888.15021]

If confirmation procedures are considered effective, they may provide higher quality evidence. The evidence provided by confirmations is strong given it comes from outside the entity.

What does 'sufficient' mean? [ISA | 3888.1600]

Sufficiency is the measure of the quantity of audit evidence.

The following table describes the two factors that affect the sufficiency of the audit evidence:

Factors	How the factors affect the sufficiency of audit evidence
CAR Risk associated with the control (RAWTC)	The higher the assessed risk, the amount of audit evidence we obtain also increases.
Quality of the audit evidence obtained (i.e. its appropriateness)	As the quality of the audit evidence increases, the less evidence (in quantity) we may obtain.

Obtaining more audit evidence, however, may not compensate for its poor quality.

What does 'appropriate' mean? [ISA | 3888.1700]

Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

What if confirmation procedures will not provide sufficient and appropriate audit evidence? [ISA | 3888.15022]

If we determine that confirmation procedures will not provide sufficient and appropriate audit evidence, we:

- perform procedures complement the evidence obtained from confirmation procedures, or
- perform alternative procedures

so that we obtain sufficient and appropriate evidence over the RMMs identified.

> For example, when confirmation of accounts payable will not provide sufficient appropriate audit evidence, we may also consider vouching accounts payable subsidiary ledger, suppliers' invoice files and disbursement records, as well as inquiring of entity personnel responsible for purchasing to identify a list of major suppliers.

2.2 Consider confirming the terms of unusual or complex transactions [ISA | 3889]

What do we do?

IF the company has entered into an unusual or complex transaction AND the combined assessed risk is high, THEN consider confirming the terms and amounts of the transaction in addition to examining documentation.

Why do we do this?

Unusual or complex transactions may present incremental risks. Sending confirmations over such transactions is an effective way to obtain reliable third party evidence in relation to the terms of such transactions. These terms may not be consistent with transactions entered into in the normal course of business and confirmations provide third party evidence, which is more persuasive evidence to support such transactions.

Execute the Audit

What is an unusual or complex transaction? [ISA | 3889.1300]

Unusual or complex transactions, which may be referred to as significant unusual transactions, may be identified through the presence of one or more of the following characteristics:

- The transaction is material to the financial statements;
- The transaction impacts the decision making of investors;
- Similar transactions have not occurred in prior periods;
- The timing of transaction is at period-end which differs from those in the normal course of business; and/or

The size of the transaction is larger than those in the normal course of business. What is "high" CAR? [ISA | 3889.1400]

A CAR of EN, SC or SN is considered "high."

What do we think about when we determine whether to confirm the terms of unusual agreements or transactions? [ISA | 3889.1500]

The table below indicates factors to think about when determining whether to confirm unusual or complex transactions identified:

Factor	What we think about
RMMs and the related audit risk	When we identify an unusual or complex transaction, we think about the identified RMMs and the related audit risk specific to accounts to determine whether to perform confirmation procedures. For example, we identify a RMM due to fraud related to the existence and accuracy of revenue at period-end and identify a large unusual revenue transaction recorded during the last 2 weeks of the period. We may send a confirmation to the customer of the transaction to confirm the existence and accuracy of the revenue transaction, as well as the specific terms of the transaction. As the combined assessed risk (CAR) associated with the RMMs related to the transaction increases, the greater the assurance necessary.
Significance of the transaction	We also think about the significance of the transaction to the account balance as a whole, and the nature of the transaction in relation to the typical transactions recorded within the account balance for which we are performing procedures. For example, we identify a large and unusual revenue transacti comprises more than 10% of the entity's total revenue and sign send a confirmation to the customer of the transaction to confir of revenue transaction, as well as the specific terms of the tran We are more likely to send confirmations for transactions that are material to the financial statements.

Complexity of the accounting related to the transaction	We think about the complexity of the accounting related to the transaction. The more complex the transaction, the higher assurance necessary. We might determine it is efficient and effective to send confirmations to confirm the terms of a complex transaction.
Nature of the transaction	We think about whether the transaction is outside the normal course of business. When the transaction is outside the normal course of business for the entity, a confirmation may be an efficient way to validate the terms of the transaction.
The independence and objectivity of the intended confirming party	If the confirming party is a related party of the entity, responses to confirmation requests may be less reliable and may not provide sufficiently persuasive audit evidence.

We also think about whether there might be side agreements or other oral modifications or agreements related to the unusual or complex transaction. When there is a higher risk of these types of arrangements exist, confirming the absence of any side agreements or other related agreements at the same time can be an effective way to obtain evidence that there are none.

Substantive Procedures Related to the Financial Statement Closing Process

International Standards on Auditing: ISA 330.20

Substantive Procedures Related to the Financial Statement Closing Process

20. The auditor's substantive procedures shall include the following audit procedures related to the financial statement closing process:

(a) Agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers; and

(b) Examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: Para. A54)

ISA Application and Other Explanatory Material: ISA 330.A54

Substantive Procedures Related to the Financial Statement Closing Process (Ref: Para. 20(b)))

A54. The nature, and also the extent, of the auditor's substantive procedures related to the financial statement closing process depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Design and perform substantive procedures related to the period-end financial reporting process [ISA | 1297]

What do we do?

Design substantive procedures related to the period-end financial reporting process

Why do we do this?

We perform specific procedures over the entity's period-end financial reporting process to respond to the risks of material misstatement. Entries and adjustments made during the period-end financial reporting process may be made under pressure or time constraints, which may result in an increase in the risk of error or inappropriate judgments made by management.

Execute the Audit

What is the period-end financial reporting process? [ISA | 1297.1300]

The period-end financial reporting process is the activities an entity or group performs to close the books and make post-closing adjustments when preparing the individual financial statements (e.g. balance sheet, statement of income) and related disclosures, collectively referred to as the financial statements. This process generally operates after or outside of the other processes and process control activities designed to record individual transactions.

Why do we perform procedures over the period-end financial reporting process? [ISA | 1297.1400]

We usually perform our audit procedures on information maintained in the accounting records, including the general and subsidiary ledgers.

Consequently, there is a risk that the financial statements may be material misstated because the information reported in the financial statements does not reconcile to the underlying accounting records we have audited, or because the information in the accounting records has been inappropriately adjusted during the period-end financial reporting process before being reported in the financial statements.

Consider a scenario where management properly accounted for and recorded every account balance and transaction during the year. However, during the period-end financial reporting

process, they made an error in compiling the financial information or made adjustments during their post-closing process that materially misstated certain accounts or disclosures. Even though the accounting throughout the year was correct, the financial statements were still materially misstated.

What procedures do we perform over the period-end financial reporting process? [ISA | 1297.1500]

Our procedures over the period-end financial reporting process include:

- demonstrating that information in financial statements agrees or reconcile with the underlying accounting records; and
- examining material adjustments made in preparing the financial statements.

1.1 Demonstrate that information in financial statements agrees or reconciles with the underlying accounting records [ISA | 1298]

What do we do?

Prepare audit documentation to demonstrate that information in the financial statements and related disclosures agrees or reconciles with the underlying accounting records

Why do we do this?

Because audit documentation is the record that supports our opinion, we demonstrate that the information in the financial statements and related disclosures agrees or reconciles to the underlying accounting records. This provides a clear link to our procedures performed and results obtained on the underlying records and thus that the account balances are presented appropriately in the financial statements.

Execute the Audit

What are 'underlying accounting records'? [ISA | 1298.1300]

Underlying accounting records include the general ledger and sub-ledgers, but also other information within the entity. This is often the information we perform our audit procedures over that is used by management to compile the financial statements.

What information in the financial statements do we reconcile? [ISA | 1298.13610]

We reconcile, or agree, the financial statements with underlying accounting records, including:

- the information in the financial statements, including reconciling comparative information to prior audited financial statements;
- the disclosures to the financial statements; and
- the presentation of the amounts in the financial statements.

How do we reconcile amounts in the financial statements with the underlying accounting records? [ISA | 1298.1400]

How we reconcile, or agree, amounts on the face of the financial statements and related disclosures with the underlying accounting records depends on the complexity of the entity's period-end financial reporting process.

In a smaller or less complex entity, our audit documentation may include schedules to evidence that we agreed the amounts in the financial statements directly to the entity's trial balance or general ledger we used for our audit procedures.

In a more complex entity with multiple subsidiaries, we may agree the amounts in the financial statements to a consolidation schedule, which we reconcile to the individual trial balances or supporting ledgers.

We also determine whether the prior-period amounts have been recorded or revised correctly.

Group audit | How do we reconcile amounts in the group financial statements with the underlying accounting records? [ISA | 1298.159835]

How we reconcile, or agree, amounts on the face of the group financial statements and related disclosures with the underlying accounting records depends on the complexity of the group's period-end financial reporting process.

We may agree the amounts in the group financial statements to a consolidation schedule, which we reconcile to the component reporting packages for components were further audit procedures are performed. The component reporting packages are reconciled to the component's trial balance or general ledger used in our audit procedures over that component.

We also determine whether the prior-period amounts have been recorded or revised correctly.

How do we reconcile financial statement disclosures? [ISA | 1298.1500]

Reconciling financial statement disclosures may involve checking the appropriateness of calculations and reconciling the amounts used in the calculations to the underlying accounting records, which may be the trial balance, general ledger, or other supporting documents.

One of the key objectives of reconciling the financial statements to the underlying accounting records is to determine whether the account balances and underlying transactions are presented appropriately in the financial statements and related disclosures. Through all of the risk assessment procedures, control testing and substantive audit procedures that we have performed throughout our audit, we have gained an understanding of the types of balances and transactions included within the entity's accounting records. With that understanding in mind, reconciling the accounting records to the financial statements is one of the steps we perform in evaluating whether amounts are presented in the appropriate financial statement captions or disclosures.

Practically speaking, we accomplish this by asking ourselves questions such as the following.

- Are the descriptions of the underlying accounting records representative of the underlying account balance and/or transactions?
- Based on the descriptions of the underlying accounting records, are they presented appropriately within the financial statement captions?
- Are there transactions or balances with specific characteristics that need special consideration when reconciling the accounting records to the financial statements (e.g. the presentation of unpaid capital expenditures within the statement of cash flows)?

- Are there financial statement captions that need to be broken out into further detail based on the financial reporting framework or the needs of the users of the financial statements?

What is our responsibility for reconciling disclosures to the underlying accounting records? [ISA | 1298.13611]

At a minimum, we reconcile all of the entity's disclosures back to the underlying accounting records or prior year audited information, regardless of the assessed level of risk of each disclosure.

If there are account balances for which we did not identify a RMM, do we reconcile those to the underlying accounting records? [ISA | 1298.13612]

Yes. We reconcile all amounts in the financial statements, including disclosures, to the underlying accounting records even if we did not identify a RMM. In addition, we determine that all the general ledger balances are included in the financial statements.

Are there situations where we agree or reconcile the financial statements to information obtained from outside of the general ledger and subsidiary ledgers? [ISA | 1298.1700]

Yes. There may be situations where we agree or reconcile information in the financial statements to information obtained from outside the general ledger and subsidiary ledgers. For example, a guarantee issued by an entity and disclosed in the financial statements is likely not recorded in the general ledger and/or subsidiary ledger. In this situation, we would reconcile this information obtained from outside the general ledger and subsidiary ledgers to this disclosure, such as the guarantee contract.

Do we evaluate the relevance and reliability of the information used to agree or reconcile the financial statements and related disclosures? [ISA | 1298.159601]

Yes. We evaluate the relevance and reliability of the information used to agree or reconcile the financial statements and related disclosures, regardless of the assessed level of risk (RM or RMM) and regardless of whether the information is from within or outside the general ledger and/or subsidiary ledger.

Information used in disclosures may already be assessed separately as part of a separate response to an RMM or as part of a risk assessment procedure when identifying an RM.

If information is not separately evaluated for relevance and reliability elsewhere, we determine the appropriate audit procedures to evaluate the reliability of the information based on our understanding of the source and nature of the information and the circumstances under which it is obtained and how the information is being used in the audit.

When we have identified a disclosure amount as an RM and are using information only to perform the required reconciliation procedure we treat it akin to how we evaluate reliability of information used in a risk assessment procedure in activity 'Evaluate the relevance and reliability of information used as audit evidence.'

How do we prepare audit documentation to demonstrate the financial statements agree or reconcile with the underlying accounting records? [ISA | 1298.1600]

In our audit documentation, we include schedules to clearly evidence that the information in the financial statements agrees to, or reconciles with, the underlying accounting records. This can include information obtained from within or outside of the general and subsidiary ledgers.

We include a financial statement 'tie-out' in the workpapers that evidences how the financial statements and disclosures reconcile with the underlying accounting records. Ordinarily, this is the trial balance, along with other subsidiary ledgers (e.g. AR or AP subledgers).

If we have identified a RMM within the business process that includes the underlying accounting records and have performed audit procedures over the information and all RDEs, we consider linking to our audit procedures to show how our audit procedures relate to the balances that we reconcile to the financial statements, providing a clear trail from the financial statements to the audit procedures performed.

> For example, if we utilize a population of payroll expenses to support our procedures performed over the accuracy of Selling, General & Administrative (SG&A) expenses, our documentation evidences how the trial balance and the financial statement caption for SG&A expenses reconciles to the population of payroll expenses (underlying record)that we tested.

Examples

What are examples of how we might evaluate information used in reconciling all amounts within a disclosure? [ISA | 1298.159836]

Underlying accounting record (information)	Inherent risk for RMMs or RMs related to the disclosure	How we might evaluate the relevance and reliability of the information
Future minimum lease payments. A preconfigured report from the Company's lease application generates the future minimum lease payments used for this disclosure. The preconfigured report represents the underlying accounting records.	Engagement team determined there was not an RMM related to the presentation and disclosure of future minimum lease payments based on: - low volume of leases and no lease modifications in the current year; - no changes in lease accounting policies; - stability in the discount rate; and - expectation of minimal changes to the disclosure.	- As the report is extracted from the lease application that captures the lease, it is considered relevant, - Inquire to understand the nature, source and RDEs to generate the report, - Compare the future minimum lease payments for the current year to the prior year schedule to identify if there are any unexpected changes in the data to assess the reliability.

Advertising expense derived directly from the company's general ledger. The advertising expenses in the general ledger represents the underlying accounting records.	Engagement team determined there was not an RMM related to the presentation of advertising cost disclosures based on: - no judgment required to record advertising expense; - no prior period misstatements or deficiencies were identified; and - no changes in the related accounting policies.	Agreed amount to the general ledger. No additional procedures needed to assess relevance and reliability as the general ledger is subject to other audit procedures.
Revenue disaggregation by category. The entity discloses revenue by country, which is derived from a system generated report from the revenue sub-ledger. The report represents the underlying accounting records.	Engagement team determined an RMM with a base inherent risk for the revenue disaggregation component of the disclosure based on: - high volume of revenue transactions in the current period; and - importance of revenue disclosures to users of the financial statement.	No additional procedures needed to assess relevance and reliability as other procedures as: - the report and the relevant data elements, including the category of revenue that is used to determine the disaggregated disclosure, were identified as information in management's disclosure control of the Revenue Note; and - the report was tested in accordance with activity 'Evaluate the relevance and reliability of information used as audit evidence'

1.2 Examine material adjustments made in preparing the financial statements [ISA | 1299]

What do we do?

Examine material adjustments made during the course of preparing the financial statements.

Why do we do this?

Another procedure we perform over the entity's period-end financial reporting process is to examine material adjustments made during the course of preparing the financial statements. Adjustments, including journal entries, made during the period-end financial reporting process provide an opportunity for misstatements to occur. By performing procedures over the material adjustments, we obtain audit evidence on whether there properly supported and appropriate.

Execute the Audit

How do we examine the material adjustments? [ISA | 1299.1300]

We perform procedures over material adjustments to provide evidence that the entry is appropriate and does not materially misstate the financial statements. Our procedures include:

- inquiry with entity personnel;
- obtaining appropriate supporting evidence (i.e. that is relevant and reliable based on the entity-specific risks associated with the adjustment);
- if the item is a recurring journal entry or other recurring adjustment, comparing it to the prior period and assessing whether it remains appropriate;
- assessing and documenting whether the journal entry or adjustment:
  - was initiated by an authorized individual;
  - was reviewed and approved by an appropriate individual consistent with entity or group policy;
  - reflects the underlying events and transactions;
  - has been recorded in the correct accounting period at appropriate amounts;
  - has been recorded to the correct general ledger accounts (or has been included in the appropriate financial statement captions);
  - is consistent with the entity's accounting policies; and
  - is indicative of management override of internal controls; and
- examining any related entries.

The nature and extent of our substantive procedures depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement (RMM).

What do we inquire about?

We inquire about:

- the nature or cause of the entry;
- the support used for the entry and whether it was appropriate;
- whether the entry was appropriately reviewed and approved; and
- whether the entry was initiated by management outside the normal course of business.

Our goal is to obtain evidence to help us evaluate whether these adjustments are appropriate and for the correct accounts and amounts. As such, while inquiry may be a helpful starting point to understand the nature of the entry, we also perform procedures to corroborate what we may be told by management, and maintain professional skepticism when we evaluate if the adjustments are appropriate.

How do we examine supporting documentation?

We examine the supporting documentation to determine whether the entry reflects the underlying transaction. This procedure includes more than a cursory review of the adjustment. The procedures we perform are consistent with any other substantive procedure to obtain sufficient appropriate audit evidence.

How do we examine related entries?

We examine entries that are impacted by the adjustment. For example, an entry impacting operating income will impact tax expense. As a result, we also:

- obtain support for the related entry; and
- assess the appropriateness of the entry.

Do we consider all adjustments throughout the period? [ISA | 1299.1400]

Not necessarily. Although misstatements could arise from either fraud or error, examining material journal entries and other adjustments made during the course of preparing the financial statements focuses on addressing the risk of error that may arise in the period-end financial reporting process. The chapter on fraud (AS 2401 , ISA 240 , AU-C 240) discusses more specific requirements and guidance regarding procedures to examine journal entries, both at period end and throughout the period.

What types of adjustments does an entity make in preparing its financial statements? [ISA | 1299.1500]

The types of adjustments made during the course of preparing the financial statements might include:

- entries made to adjust for new or updated information impacting the financial statements - e.g. post-closing entries to update a litigation accrual for an adjusting or Type 1 subsequent event;
- entries made to correct misstatements identified by us or management - e.g. adjustments to accrued expenses for expenses incurred before period end that were not reserved for;
- entries made to reclassify amounts for financial reporting purposes - e.g. reclassifying the current portion of long-term debt so that it is presented properly on the balance sheet;
- consolidation and elimination entries - e.g. elimination of intercompany profits; and
- entries to record foreign currency translation adjustments.

How do we determine which adjustments to examine? [ISA | 1299.1600]

We examine those adjustments we consider either quantitatively or qualitatively material. From a quantitative perspective, we examine individual adjustments for which the sum of all debit (and separately all credit) amounts exceed materiality. From a qualitative perspective, we consider those adjustments that may be qualitatively material based on its description or the account to which it is recorded. We consider similar factors to those we use when we establish/re-assess materiality.

Are there other adjustments to examine? [ISA | 1299.13608]

We may consider setting a threshold (e.g. looking at all entries over a certain monetary amount) that does not exceed some percentage of our performance materiality when examining adjustments from a quantitative perspective. In determining that percentage, we may consider whether the entries not examined have a more than remote likelihood of aggregating into a material misstatement. For example, if we find the population of adjustments to be hundreds of entries that range from 20% of performance materiality to 100% of performance materiality, we would likely have a threshold that is a lower percentage of performance materiality than we would in a situation where there are only

30 adjustments and all but two of them do not even exceed our posting threshold. If this RMM is greater than remote, we examine additional entries until we have reduced our detection risk to an appropriately low level.

From a qualitative perspective, we may identify adjustments below the quantitative threshold set, which could have other impacts to the financial statements. For example, when an entity has debt covenants that are dependent on certain financial ratios or results, we may identify adjustments below the threshold that could impact debt covenant compliance. In this case, we would choose to examine these entries based on their qualitative characteristics. The same could be said for reclassification adjustments between accounts that impact key ratios or metrics (e.g. reclassifications between balance sheet accounts that impact a working capital ratio).

How can our procedures over material adjustments impact other areas of the audit? [ISA | 1299.1700]

Material adjustments may impact other areas of the audit where we have already made a preliminary conclusion. A material adjustment may result in that preliminary conclusion being incorrect. In addition, a material adjustment may result in a new RMM that we had not previously identified.

> For example, consider a situation where we noted that sales are expected to be lower in the future because of a new competitor in the market. Although management considered the impacts on their inventory valuation and made a post-closing adjustment to account for them, we also consider other impacts, as set out below.
>
> - How might this information impact other accounts that are influenced by cash flow projections, such as goodwill or intangible assets?
> - Do the projected cash flows used by management appropriately consider the impact of the competitor's product?
> - Are the cash flow projections reasonable in light of this new information, or does this represent contradictory or disconfirming evidence?
> - Are our initial risk assessments still appropriate, or do we need to revise them?

What if we are unable to obtain supporting documentation? [ISA | 1299.1800]

If we are unable to obtain supporting documentation, or sufficient appropriate audit evidence, we consider the implications that has on our ability to opine on the financial statements.

Do we consider anything else in an integrated audit or where we have placed reliance on controls? [ISA | 1299.1900]

In an integrated audit or where we have placed reliance on relevant controls, we separately consider the control implications of the adjusting entry, specifically, whether the applicable process risk points have been addressed and whether the entity's controls are operating effectively.

What if we identify disconfirming audit evidence? [ISA | 1299.2000]

If we identify disconfirming audit evidence , we:

- include documentation of the disconfirming evidence in the audit file; and
- consider disconfirming evidence when concluding whether we have obtained sufficient appropriate audit evidence.

Examples

How might we examine a material adjustment? [ISA | 1299.2300]

Fact pattern

The engagement team identifies that management made a material adjustment to reduce the value of inventory as part of the period-end financial reporting process. When the team inquires of management to understand why the adjustment was made, they are initially told that a competitor introduced a new product that's expected to adversely impact sales of the entity's product. The engagement team then probes further to understand how the adjustment was made and whether the amount is appropriate, including considering sales trends towards the period end and the beginning of the following period, as well as obtaining additional support for the entry.

Analysis

When the engagement team examine the details of how management determined the amount to record, they identify that the amount of the impairment adjustment determined in management's analysis does not match the amount that was actually recorded. Had the team only performed inquiry and not examined more information about the adjustment, they may not have discovered that the adjustment resulted in a misstatement to the financial statements.

The team considers the impact of the misstatement on their audit results. In addition, they will consider the impact of a new product being introduced in their risk assessment, to determine whether they need to make any changes to their audit strategy as a result of a new risk being identified.

Substantive Procedures Responsive to Significant Risks

International Standards on Auditing: ISA 330.21

Substantive Procedures Responsive to Significant Risks

21. If the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details. (Ref: Para. A55)

ISA Application and Other Explanatory Material: ISA 330.A55

Substantive Procedures Responsive to Significant Risks (Ref: Para. 21)

A55. Paragraph 21 of this ISA requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor

identifies that management is under pressure to meet earnings expectations, there may be a risk that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmation procedures not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmation procedures with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Perform substantive procedures that respond to significant risks [ISA | 1266]

What do we do?

IF we identify a significant risk, THEN perform substantive procedures that specifically respond to the assessed risk

Why do we do this?

In situations where we have a significant risk, we design our substantive audit procedures so their nature, timing and extent properly address the risk of material misstatement (RMM).

Execute the Audit

What is a significant risk? [ISA | 1266.1400]

A significant risk is a risk of material misstatement (RMM) which is:

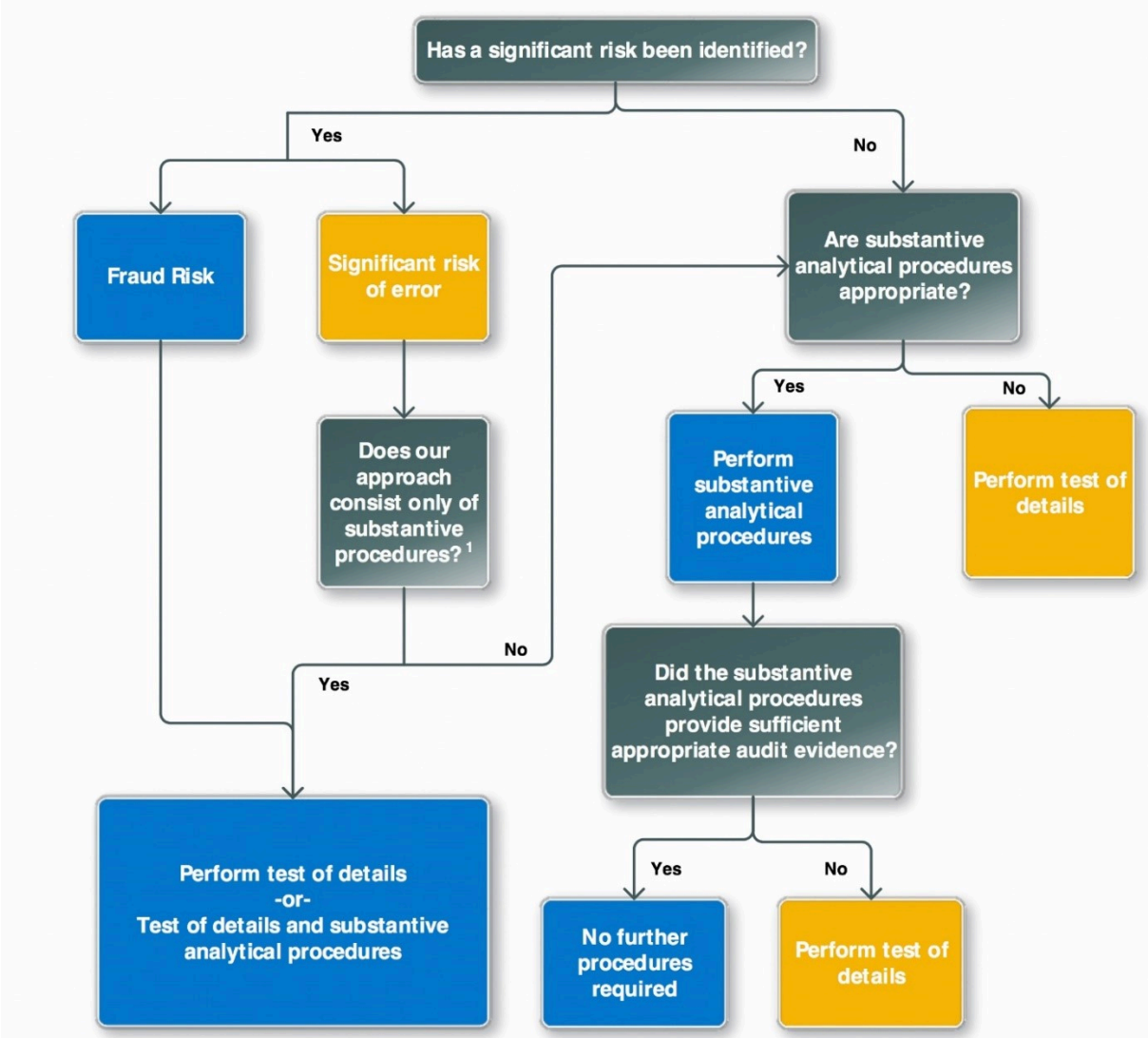
- close to the upper end of the continuum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur; or
- fraud risks; or
- significant unusual transactions with related parties.

We document special audit considerations in response to significant risks.

What substantive procedures do we perform to respond to a significant risk? [ISA | 1266.11989]

We select our procedures that would be responsive to the assessed risks. When the approach to a significant risk due to error consists only of substantive procedures (i.e., either we have not tested the operating effectiveness or such controls were not operating effectively), those procedures shall include tests of details. However, for significant risks of fraud (i.e., fraud risks), the substantive procedures we perform always include test of details, even when we have tested controls and determined they operate effectively.

The following decision tree summarizes the substantive procedures we perform in response to identified risks:



In addition, the nature, timing and extent of our substantive procedures differ from what we perform in the absence of a significant risk (see activity 'Design and perform substantive procedures to respond to the level of CAR').

Why do we alter the nature, timing and extent of our procedures for a significant risk? [ISA | 1266.1600]

We alter the nature, timing and extent of our procedures because we obtain more persuasive evidence for a significant risk than for other risks.

How do we alter our substantive procedures to respond to a significant risk? [ISA | 1266.1700]

To respond to a significant risk we may:

- design procedures that by their nature are more persuasive - e.g. use confirmation with a third party instead of inspection of documents, change our method of selecting items;
- change the nature of our procedures by designing and performing additional substantive procedures - e.g. perform both a substantive analytical procedure (SAP) and tests of details.

For example, management is under pressure to meet earnings expectations. A risk may exist that they respond to this pressure — for example, by inflating sales through:

- improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition; or
- invoicing sales before shipment and before control transfers.

Had no significant risk existed, we may have performed a test of details by inspecting invoices, bills of lading and proof of payment for a selection of sales transactions.

But having identified a significant risk, we choose to also design external confirmation procedures that confirm outstanding amounts and the details of the sales agreements with the customer - including dates, any rights of return and delivery terms. We also supplement these confirmations with inquiries of the entity's non-financial personnel about any changes in sales agreements and delivery terms.

Simply increasing the number (i.e., sample size) of sales transactions to inspect may be insufficient.

It may be helpful to ask ourselves what we are doing differently since we identified a significant risk. If the answer is nothing, then we may not have addressed the significant risk appropriately.

Can we only test the operating effectiveness of controls in response to a significant risk? [ISA | 1266.11790]

No. Testing the operating effectiveness of control activities as our *only* response to a significant risk is not appropriate. We also perform tests of details to address the significant risk.

However, we may choose to test the operating effectiveness of controls as part of our response to a significant risk.

Timing of Substantive Procedures

International Standards on Auditing: ISA 330.22-23

Timing of Substantive Procedures

22. If substantive procedures are performed at an interim date, the auditor shall cover the remaining period by performing:

(a) substantive procedures, combined with tests of controls for the intervening period; or

(b) if the auditor determines that it is sufficient, further substantive procedures only,

that provide a reasonable basis for extending the audit conclusions from the interim date to the period end. (Ref: Para. A56-A59)

23. If misstatements that the auditor did not expect when assessing the risks of material misstatement are detected at an interim date, the auditor shall evaluate whether the related assessment of risk and the planned nature, timing or extent of substantive procedures covering the remaining period need to be modified. (Ref: Para. A60)

ISA Application and Other Explanatory Material: ISA 330.A56-A60

Timing of Substantive Procedures (Ref: Para. 22-23)

A56. In most cases, audit evidence from a previous audit's substantive procedures provides little or no audit evidence for the current period. There are, however, exceptions, for example, a legal opinion obtained in a previous audit related to the structure of a securitization to which no changes have occurred, may be relevant in the current period. In such cases, it may be appropriate to use audit evidence from a previous audit's substantive procedures if that evidence and the related subject matter have not fundamentally changed, and audit procedures have been performed during the current period to establish its continuing relevance.

Using audit evidence obtained during an interim period (Ref: Para. 22)

A57. In some circumstances, the auditor may determine that it is effective to perform substantive procedures at an interim date, and to compare and reconcile information concerning the balance at the period end with the comparable information at the interim date to:

(a) Identify amounts that appear unusual;

(b) Investigate any such amounts; and

(c) Perform substantive analytical procedures or tests of details to test the intervening period.

A58. Performing substantive procedures at an interim date without undertaking additional procedures at a later date increases the risk that the auditor will not detect misstatements that may exist at the period end. This risk increases as the remaining period is lengthened. Factors such as the following may influence whether to perform substantive procedures at an interim date:

- The control environment and other controls.
- The availability at a later date of information necessary for the auditor's procedures.
- The purpose of the substantive procedure.
- The assessed risk of material misstatement.
- The nature of the class of transactions or account balance and related assertions.
- The ability of the auditor to perform appropriate substantive procedures or substantive procedures combined with tests of controls to cover the remaining period in order to reduce the risk that misstatements that may exist at the period end will not be detected.

A59. Factors such as the following may influence whether to perform substantive analytical procedures with respect to the period between the interim date and the period end:

- Whether the period-end balances of the particular classes of transactions or account balances are reasonably predictable with respect to amount, relative significance, and composition.
- Whether the entity's procedures for analyzing and adjusting such classes of transactions or account balances at interim dates and for establishing proper accounting cutoffs are appropriate.
- Whether the information system will provide information concerning the balances at the period end and the transactions in the remaining period that is sufficient to permit investigation of:

  (a) Significant unusual transactions or entries (including those at or near the period end);

  (b) Other causes of significant fluctuations, or expected fluctuations that did not occur; and

(c) Changes in the composition of the classes of transactions or account balances.

Misstatements detected at an interim date (Ref: Para. 23)

A60. When the auditor concludes that the planned nature, timing or extent of substantive procedures covering the remaining period need to be modified as a result of unexpected misstatements detected at an interim date, such modification may include extending or repeating the procedures performed at the interim date at the period end.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Design and perform substantive procedures whose timing is responsive to CAR [ISA | 1290]

What do we do?

Design and perform substantive procedures whose timing is based on and responsive to the combined assessed risk of the risk of material misstatement

Why do we do this?

Performing audit procedures at different points throughout the audit (i.e. interim or period-end) can alter the evidence we obtain.

We appropriately plan the timing of our audit procedures so that we perform procedures to obtain sufficient appropriate audit evidence to respond to risks of material misstatement (RMMs).

Execute the Audit

What are the approaches to the timing of substantive procedures? [ISA | 1290.10829]

The three different approaches to the timing of substantive procedures are:

Approach	Description
Approach 1 Perform procedure at an interim date and roll forward	We perform our substantive audit procedures at an interim date and perform procedures to extend our audit conclusions to period-end ('rollforward procedures').
Approach 2 Perform the procedure throughout the period	We perform part of our procedures at an interim date, then perform remaining substantive audit procedures at period-end. The substantive procedure is therefore not complete until the period-end, when we have obtained sufficient appropriate audit evidence.

	For example, we are testing certain revenue transactions related to an RMM using audit sampling for a calendar year end entity. To perform procedures on the population using approach 2 we: • sample and perform substantive procedures over items using the actual population through September 30; • sample and perform the same substantive procedures over items using the actual population from the period October 1 through December 31; and • Combine the two samples during evaluation to conclude on the full year of activity as we have tested cumulative items. Although we performed some of our procedures at an interim date (September 30), we have not tested a sufficient number of items until we complete our testing through the period-end.
Approach 3 Perform the procedure at period-end only	We perform substantive procedures at period-end (i.e., during final fieldwork) to obtain sufficient appropriate audit evidence instead of performing the procedures at several points of time throughout the period. For example, we determine the appropriate sample size based on the period-end account balance or the activity for the entire period and perform the procedures during final fieldwork.

What are the benefits and risks of each approach to the timing of substantive audit procedures? [ISA | 1290.10830]

The following table describes the benefits and risks of each approach to the timing of substantive audit procedures:

Approach	Benefits	Risks
Approach 1	**Early identification of issues** Identifying issues early gives management and us time to respond to those issues earlier in the audit. **Reduce last-minute decisions** This approach reduces the likelihood of making all or too many of our critical decisions and judgments too close to period-end.	**Material misstatement in the remaining period** The earlier the interim date, the greater this risk becomes. **New information contradicting initial risk assessments or introducing new risks** We may obtain new information that introduces a new risk, or contradicts

	Resources We have a finite amount of resources and time between period-end and issuing our report, so it may not be practical to perform all of our audit procedures at period-end. This approach spreads the work over a longer period.	the information on which we based our initial risk assessments or is not addressed by the procedure we already performed. For example, we may have based our sample sizes on a CAR assessment of Base Controls Reliance 'BC'. If we subsequently increase inherent risk (and therefore CAR changes), then we have not tested enough items and we have additional procedures to perform. **Increase in detection risk** There is an increased risk that we may not detect material misstatements that may exist at the period end. This risk increases as the length of the rollforward period increases.
Approach 2	**Early identification of issues** **Does not increase detection risk** We don't increase detection risk because our procedures address the entire audit period.	**New information contradicting initial risk assessments or introducing new risks**
Approach 3	**Avoid inefficiencies** This approach is useful when we are addressing an RMM that relates to the period-end. For example, when performing procedures over a recurring fair value measurement (e.g. trading securities), the procedures we perform at an interim date may not provide evidence over the	**Resources** Performing procedures at period-end may result in time pressure on the entity and engagement team. **Late identification of issues** If we identify additional RMMs that we had not identified at planning, we have less time to respond.

	valuation at period-end and therefore may be repeated. We have access to a complete population of the underlying transactions to perform our testing. **Does not increase detection risk**	

How do we design and perform substantive procedures whose timing is responsive to the combined assessed risk (CAR) of the RMM? [ISA | 1290.1400]

To design and perform substantive procedures whose timing is responsive to the CAR of the RMM, we perform the following activities:

- Determine the approach to the timing of substantive procedures;
- If we use approach 1 then perform relevant procedures.

Do we perform all our substantive procedures using the same approach to timing? [ISA | 1290.1600]

No. We tailor our substantive procedures to obtain sufficient appropriate audit evidence to respond to CAR of the RMM. Not all substantive procedures are performed at the same time in the same way, and it may not be appropriate to design and perform our procedures using the same approach.

We also think about performing procedures on an unannounced basis or at an unpredictable time when determining the timing of our substantive procedures.

Examples

What substantive procedures may we perform using approach 1? [ISA | 1290.2500]

Test of Details

Fact pattern

During planning and risk assessment, the engagement team identify the following RMMs related to overstatement or understatement of revenue:

- revenue transactions may be recorded using incorrect prices; and
- revenue transactions may be recorded using incorrect quantities.

For both RMMs, CAR is assessed as Base Controls Reliance ('BC').

To respond to these RMMs, the team plans to perform the following substantive procedure for revenue.

- Select a sample of sales invoices;
- Vouch the invoice to shipping documents; and
- Agree total invoice amount to the cash receipt.

Analysis

Interim procedures:

The engagement team select and perform the substantive procedure over a sample of invoices from the period January 1 to October 31. After performing the procedures, the team evaluate the results as of October 31.

Rollforward procedures:

After comparing the interim and period-end information, they identify and investigate unusual items over which they perform separate substantive audit procedures. After thinking about the specific RMM(s) and changes (or lack thereof) in the rollforward period, the team determine to use a substantive analytical procedure (SAP) that predicts revenue for the roll forward period.

At both interim and period-end, the engagement team uses SPM when developing their procedures.

Substantive Analytical Procedures

Fact pattern

During planning and risk assessment, the engagement team identify the following RMMs related to overstatement or understatement of revenue:

- revenue transactions may be recorded using incorrect prices; and
- revenue transactions may be recorded using incorrect quantities.

For both RMMs CAR is assessed as Base Controls Reliance ('BC').

Analysis

Interim procedures:

The team design and perform a SAP that develops an expectation of the amount of revenue recorded from January 1 to October 31. After performing the procedures, they evaluate the results as of October 31.

Rollforward procedures:

After comparing the interim and period-end information, they identify and investigate unusual items over which they perform separate substantive audit procedures. Then they select a sample of invoices, vouch the invoice to shipping documents and agree total invoice amount to the cash receipt

At both interim and period-end, the engagement team uses SPM when developing their procedures.

What substantive procedures may we perform using approach 2? [ISA | 1290.2700]

Test of Details

Fact pattern

During planning and risk assessment, the engagement team identify the following RMMs related to overstatement or understatement of revenue:

- revenue transactions may be recorded using incorrect prices; and
- revenue transactions may be recorded using incorrect quantities.

For both RMMs CAR is assessed as Base Controls Reliance ('BC').

Analysis

Interim procedures:

To perform the procedures throughout the period, the engagement team use audit sampling using full performance materiality to select sales invoices recorded from January 1 to October 31 and perform their procedures. The team do not reach a conclusion as at the interim date.

Period-end procedures:

The team use audit sampling using full performance materiality to select sales invoices recorded from November 1 to December 31. They evaluate the results of their procedures for the entire period (including both interim and final) to reach a conclusion at period end.

What substantive procedures may we perform using approach 3? [ISA | 1290.10843]

Test of Details

Fact pattern

During planning and risk assessment, the engagement team identify the following RMMs related to overstatement or understatement of revenue:

- revenue transactions may be recorded using incorrect prices; and
- revenue transactions may be recorded using incorrect quantities.

For both RMMs CAR is assessed as Base Controls Reliance ('BC').

Analysis

There are no substantive procedures performed at interim. The team use audit sampling to select sales invoices recorded from January 1 to December 31, and evaluate the results of their procedures for the entire period at period-end.

1.1 Determine the approach to the timing of substantive procedures [ISA | 1291]

What do we do?

Determine whether to use approach 1, 2 or 3 to the timing of substantive audit procedures, considering relevant factors

Why do we do this?

We determine the timing of our substantive procedures to appropriately tailor our response to identified risk(s) of material misstatement (RMMs). As part of this determination, we consider several factors that impact which approach is most appropriate in the circumstances.

Execute the Audit

How do we determine whether to use approach 1, 2 or 3 to the timing of substantive audit procedures, considering relevant factors? [ISA | 1291.10844]

The following table describes the factors we consider when determining whether to use approach 1, 2 or 3 to the timing of substantive audit procedures:

Assessed risk of material misstatement	
Combined Assessed Risk (CAR) of the RMM	As inherent risk increases and/or we have not controls reliance, it may become more appropriate to perform our substantive procedures nearer to, or at the period-end to obtain more persuasive evidence over the RMM. As our CAR may be reassessed during the period, we think about the impact that revisions may have on the timing of the substantive procedure (see question 'How does a CAR reassessment impact the timing of our substantive audit procedures?').
Significant risk(s) (including fraud risks-including financial statement level fraud risks), if any, associated with the RMM(s);	The timing of our substantive procedures coincides with our assessment of when the material misstatement could occur. For example, a significant risk related to revenue that could occur throughout the entire period may indicate that approach 2 is more appropriate. This is because we have a large number of similar transactions throughout the year related to the same RMM, including period-end. In contrast, significant risks related to balance sheet accounts or period-end cut-off indicate that performing substantive procedures at period-end may be more appropriate. It may still be appropriate to use approach 1 to address significant risks. In these instances, the procedures we perform at interim to respond to: • the nature of the significant risk; and • the timing of when we think the significant risk could result in a material misstatement. For example, fraud risks may arise from a significant unusual transaction, such as a

	business combination that arises early in the period. The estimation involved may give rise to a significant risk where it is beneficial to perform procedures over the related RMM(s) at an interim date. On the other hand, a fraud risk that arises at period-end, such as an RMM related to the valuation of a workers' compensation accrual is audited at the period-end date.
Assessment of control risk for the RMM(s)	Since CAR comprises both inherent and control risk, if we do not have control reliance, the persuasiveness of audit evidence from substantive procedures increases. If we are using approach 1 when: • transactions in the rollforward period are not well controlled (or we don't have evidence to support the operating effectiveness of those control activities); or • we have identified deficiencies in the entity's CERAMIC, the likelihood that a material misstatement is not prevented or detected/corrected increases. The likelihood of a material misstatement arising also increases as the length of the rollforward period increases. Because of this increased risk we may choose not to use approach 1 when control risk is assessed as No Controls Reliance and when the rollforward period is longer. Therefore, it may be more appropriate to perform substantive audit procedures closer to period-end in these instances.
The effectiveness of the control environment and relevant controls	An effective control environment may allow us to conduct some audit procedures at an interim date rather than at the period-end. Deficiencies in the control environment have the opposite effect; for example, we may

	respond to an ineffective control environment by conducting more audit procedures as of the period-end rather than at an interim date.
Known or expected changes in the rollforward period	
Expected changes in the entity, the environment in which the entity operates, or the entity's ICFR that impact the RMM(s)	If changes have occurred or are expected to occur in the entity's business or environment that give rise to new classes of transactions or account balances during the remaining period, this may mean that: • the RMMs are not the same throughout the entire period; or • there may be additional RMMs during the remaining period. We may decide that approach 1 is not appropriate, and to perform different or additional procedures at or near period-end to address those different RMMs. Changes to the entity's business and financial reporting process during the remaining period may impact: • our identification of the previously identified applicable process risk points (PRPs); and/or • our conclusions on the operating effectiveness of process control activities that address the applicable PRPs. These changes may impact our assessment of control risk and CAR, which has implications for the timing of our substantive audit procedures as indicated above.
Changes to the composition of the account balance or transaction class	If we expect significant changes in the account balance, or disclosure between interim and period-end, and these changes can't be estimated in advance, then it is appropriate to test at period-end. For example, when performing audit procedures over an entity's provision for litigation, we may expect that there will be

significant developments in the litigation throughout the period.

In that situation, we may not obtain sufficient audit evidence in order to conclude on the related RMM from performing testing earlier in the period, since future developments may impact the amounts recorded at the period-end.

When there have been significant changes in the composition of an account balance between interim and period-end, or there has been unusual activity in the rollforward period, rollforward procedures may not be appropriate.

For example, when performing audit procedures over trade payables at interim, where turnover in the rollforward period is high, we do not have evidence over the trade payable balances at period-end and therefore can't extend our conclusion as the items in the population have changed.

Nature of the substantive procedures

We can only perform some substantive procedures for certain RMMs at or after the period-end.

For example, there are certain audit procedures where evidence can only be obtained at or after the period end:

- Agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers;
- Examining adjustments made during the course of preparing the financial statements; and
- Procedures to respond to a risk that, at the period end, the entity may have entered into improper sales contracts, or transactions may not have been finalized.

The ability of the auditor to perform the necessary audit procedures to cover the remaining period	
Ability to address the RMM(s) in the remaining periods with procedures that provide sufficient appropriate audit evidence.	When we perform procedures at an interim date and roll forward, we still perform certain procedures to extend our audit conclusions to period end. When we can't perform procedures to address the remaining period, we perform procedures at period-end instead.
Availability/timing of relevant information	For example, a transaction may be completed, but the entity may still be gathering information to account for the transaction. We can't conclude on the accounting and the related RMM until the entity has completed its process.

Nature of the RMM and the related class of transactions, account balance, disclosure or relevant assertions

RMMs that are related to transactions recorded throughout the period (income statement accounts and certain balance sheet accounts such as additions within property, plant and equipment) are more suited to approach 1 than accounts where:

- transactions are not recorded consistently during the period; or
- the balances are primarily determined at period-end such as certain accruals and fair value measurements.

When we perform substantive audit procedures over a distinct, isolated transaction such as a debt issuance or acquisition that occurred earlier during the period, testing at interim may be appropriate.

How does a reassessment of CAR impact the timing of our substantive audit procedures? [ISA | 1291.10845]

The following table describes the potential impacts on each of the approaches on substantive procedures if CAR is reassessed:

Approach	Potential impacts
Approach 1	If we have not already performed procedures, we may decide to use another approach (i.e., Approach 2 or 3). If we have already performed our procedures, we re-assess our audit conclusion to determine whether it remains appropriate. It may be

	necessary for us to reperform our substantive procedures again at period-end or go back and supplement our testing from the interim and/or rollforward period to respond to the change in CAR.
Approach 2	When CAR has been reassessed during the period under audit, we think about the procedures we performed at interim and perform additional testing to take into account the increased CAR.
Approach 3	When we design our procedures, we design them to address the reassessed CAR so that the procedures are sufficient to address the increased risk that exists during the period.

Examples

How may the nature of the account balance determine which approach to use when determining the timing of substantive procedures? [ISA | 1291.2500]

Scenario 1 | One-time transaction

Fact pattern

Company A enters into a purchase and sale agreement with Company B to buy all outstanding shares of Company B. The transaction closes on April 30, 20X1. Company A records the purchase transaction into its general ledger for quarterly reporting as of June 30, 20X1. The engagement team are determining whether to perform procedures over the transaction at an interim date.

Analysis

In this case, the transaction occurred earlier in the period and the accounting is complete at an interim date. Testing the transaction at interim is an effective strategy to accelerate the execution of some of their substantive audit procedures.

Scenario 2 | Seasonal transactions

Fact pattern

Company X is a retailer with seasonal sales. Company X has steady sales during the first nine months of the year, but sells the majority of its products during the last three months of the year.

The engagement team are determining whether to perform their procedures over an RMM related to sales at an interim date. For the rollforward period, they plan to use the audit evidence from interim to develop an expectation of sales in the final quarter (SAP).

Analysis

Testing sales at an interim date is not appropriate in this situation because the majority of sales occur in Company X's last quarter, and there may not be a plausible relationship between the sales transactions tested at interim and the sales transactions recorded in the last three months of the year.

1.2 If we use approach 1 then perform relevant procedures [ISA | 1294]

What do we do?

IF we determine to use approach 1 to perform substantive procedures THEN perform relevant procedures

Why do we do this?

Performing procedures at an interim date introduces additional detection risk that is not present when we perform our audit procedures at period-end. This additional risk exists because we rely on the audit evidence we obtained at interim to conclude that the risks of material misstatements (RMMs) are addressed, accepting less persuasive audit evidence in the rollforward period.

Execute the Audit

What procedures do we perform if we use approach 1 to perform substantive procedures? [ISA | 1294.1800]

We perform the following procedures if we use approach 1:

- Compare information to identify and investigate items that appear unusual; and
- Perform additional audit procedures over the remaining period.

1.2.1 Compare information to identify and investigate items that appear unusual [ISA | 1292]

What do we do?

Compare relevant information from interim to period-end to identify and investigate amounts or trends/activities that appear unusual to provide the basis for extending audit conclusions from interim.

Why do we do this?

When there have been significant changes in the composition of an account balance between interim and period-end, or there has been unusual activity in the rollforward period, it can influence the level of testing necessary in the rollforward period or alter our approach altogether. Identifying and investigating unusual amounts or trends/activities helps us determine if approach 1 remains appropriate, and determine what additional audit procedures we perform for the rollforward period.

Execute the Audit

What is an amount or trend/activity that appears unusual? [ISA | 1292.10902]

Unusual amounts or trends/activities are those that seem out of the ordinary and/or not in line with our expectations. To define what is unusual, it is helpful to think about what we expect to see or what we believe is 'normal' for an account balance or transaction class and identify the items that do not meet that expectation.

Determining whether an amount or trend/activity is unusual depends on the RMM associated with the transaction class or the composition of the account balance. To make this determination, it is helpful to:

- identify information that is relevant to the RMM;
- establish appropriate benchmarks for that information; and
- determine ranges surrounding those benchmarks so that we may identify significant unusual items.

What level of comparison of relevant information from interim to period-end do we perform? [ISA | 1292.10903]

The level of comparison we perform depends on:

- the account balance or transaction class;
- the assessed CAR; and
- the relevant characteristics of the transactions in the account.

However, it is more than simply comparing the total account balance between periods and understanding the nature of the change. The objective is to identify if there are unusual items or trends/activities during the rollforward period. To do this may mean we compare information at a more detailed level rather than at the total account balance.

How do we determine the level of comparison?

To determine the level of comparison, we think about the original factors that gave rise to the RMM and determine if those factors have changed from interim.

> For example, if the RMM is related to the collectability of accounts receivable, comparing the total accounts receivable balance from interim to period-end may not provide much audit evidence about whether or not the risks associated with the valuation of accounts receivable has changed from interim.
>
> Comparing the aging of receivables between interim and period-end by major customer and for all other customers in the aggregate may provide us with the evidence to appropriately perform this comparison.

What if we identify unusual amounts or trends/activities when comparing relevant information from interim to period-end? [ISA | 1292.10905]

If we identify unusual amounts or trends/activities when comparing relevant information from interim to period-end we:

- investigate those items to understand what they represent;
- think about whether it is appropriate to revise our initial risk assessment; and
- think about the sufficiency of the procedures we have performed at the interim date.

If we determine our initial risk assessments to be appropriate, we perform substantive procedures over the unusual items.

Examples

What if we identify unusual amounts or trends/activities when comparing relevant information from interim to period-end? [ISA | 1292.2000]

Fact pattern

The engagement team are performing a financial statement audit of a calendar year-end entity that records routine/non-judgmental revenue transactions throughout the year (i.e. revenue is recognized when the product is shipped). The average sales price per order is $500 - $2,000.

During their planning and risk assessment, the engagement team identify the following RMMs related to:

- revenue transactions may be recorded using incorrect prices; and
- revenue transactions may be recorded using incorrect quantities,

Both of these RMMs may result in an overstatement or understatement of revenues or trade accounts receivable.

The engagement team assess CAR as Base Controls Reliance 'BC'.

To address these risks, the team plan to perform the following substantive audit procedure for revenue.

- Select a sample of revenue transactions and vouch relevant elements to the shipping document signed by the carrier, the purchase order and the total sales amount to the cash receipt.

Interim procedures:

The engagement team use audit sampling to select revenue transactions recorded from January 1 to October 31. After performing their procedures, they evaluate the results and conclude as of October 31. They also confirm the average sales price per order is consistent with their understanding above.

Rollforward procedures:

As one of their procedures to roll forward their interim conclusion from November 1 to December 31, the engagement team decide to perform a substantive analytical procedure (SAP) - trend analysis to identify any sales that are unusual based on their understanding.

The engagement team identify six sales transactions that were recorded at an average of $15,000 each.

Analysis

Based on their understanding of the entity's business and their test work performed as of October 31, the engagement team identify these six transactions as unusual. They perform additional procedures over these six transactions.

1.2.2 Perform additional audit procedures over the remaining period [ISA | 1293]

What do we do?

IF we performed the procedure at an interim date, THEN perform additional audit procedures over the remaining period

Why do we do this?

Performing substantive procedures at an interim date without undertaking additional procedures at a later date increases the risk that we will not detect misstatements that may exist at the period end. This risk increases as the remaining period is lengthened. As a result, we perform these procedures to reduce detection risk to an acceptably low level.

Execute the Audit

What additional audit procedures do we perform over the remaining period? [ISA | 1293.1300]

If we performed procedures at an interim date, we perform substantive procedures, which may be combined with tests of controls, over the remaining period including items identified in accordance with 'Compare information to identify and investigate items that appear unusual'. We perform substantive procedures regardless of whether we are relying on controls over the remaining period.

The substantive procedures we perform may differ from those we performed at the interim date.

In addition, we think about the population of items that were not deemed to be significant unusual items, and we perform appropriate substantive procedures to address any residual RMM that may remain in that population until it has been reduced to an acceptably low level.

The following table describes the factors we think about when determining the nature, timing and extent of rollforward procedures:

Factor	Circumstances that indicate more persuasive evidence is necessary	Circumstances that indicate less persuasive evidence is necessary
The effectiveness of the control environment and other relevant controls	We identify weaknesses in the control environment and other relevant controls.	We conclude that the control environment is, and other relevant controls are effective.
Our assessment of inherent risk of error	We assess inherent risk as Elevated or Significant.	We assess inherent risk as Base.
Whether fraud risks exist and the nature of those risks	We identify and assess that a fraud risk exists.	We do not identify a fraud risk.

The length of the rollforward period	The remaining rollforward period is longer.	The remaining rollforward period is shorter.
The nature of the significant account or disclosure and relevant assertions, including the predictability of the account balance (and/or the transactions in the balance)	Judgmental, less predictable, etc.	Routine, non-judgmental, more predictable, etc.

An evaluation of these factors may result in our determination that more persuasive audit evidence during the remaining period is to be obtained.

For example, when inherent risk for the relevant assertion and/or the length of the remaining period increases, we may perform a predictive substantive analytical procedure (SAP) or tests of details, instead of a ratio and/or trend analysis SAP.

How do we determine whether to perform a SAP for the remaining period?

When planning substantive audit procedures to address the remaining period, we think about whether SAPs can be effectively designed and performed to address the remaining period.

The following factors may influence whether to perform SAPs with respect to the rollforward period

- whether the period-end balances of the particular significant accounts and disclosures are reasonably predictable with respect to amount, relative significance, and composition;
- whether the entity's procedures for analyzing and adjusting such significant accounts and disclosures at interim dates, and for establishing proper accounting cutoffs, are appropriate;
- whether the information system relevant to financial reporting will provide information concerning the balances at the period end and the transactions in the remaining period that is sufficient to permit investigation of:
    - significant unusual transactions or entries (including those at or near the period end);
    - other causes of significant fluctuations, or expected fluctuations that did not occur; and
    - changes in the composition of the significant accounts.

We also think about what we learned when we compared relevant information about the account balance at the interim date with that at period-end. We may learn that there are changes during the rollforward period, such as significant unusual transactions or entries (including those at or near the period end), or other causes of significant fluctuations, which may make a SAP inappropriate as a rollforward procedure.

For example, if a new competitor enters the market during the fourth quarter, fourth-quarter revenues may be negatively impacted in a way that makes revenues less predictable. As a result, we determine that a SAP is not an appropriate rollforward procedure.

Does the comparison of the information from interim to the period-end constitute a SAP?

It depends. Simply comparing the significant account balance or disclosure at the interim date to the significant account balance or disclosure at period end, and understanding the nature of the change is not considered an appropriate substantive procedure without appropriately developing an expectation of the period end balance. However if we develop an expectation of the period end balance and design and perform our SAP in accordance with the chapter on 'Substantive Analytical Procedures' (ISA 520, AU-C 520, AS 2305) this may satisfy both the objectives of a rollforward procedure and the activity 'Compare information to identify and investigate items that appear unusual'.

> For example, in a non-capital intensive business with a calendar year-end, the engagement team determines it will test the interim balances as of October 31. It may be sufficient to develop an expectation that the balance of property, plant, and equipment will remain consistent as of the period-end date. We scan the roll-forward for the account noting no movements greater than performance materiality. This may be adequate audit evidence for the financial statement assertion of completeness, accuracy and existence of property, plant, and equipment.
>
> However, in a financial statement balance such as accounts receivable with average 30-day turn-over periods and significant activity, this approach may not be sufficient and we may perform tests of details over components of the roll-forward period activity as well as more persuasive evidence about the existence of unusual items in the period end balance and their propriety.

When we separate the entire account balance or transaction class into portions for testing, we consider whether sub-population performance materiality (SPM) is applicable to our procedures (see activity 'Determine SPM if applicable').

When addressing an RMM related to an income statement account, can we use the interim information as an input in our SAP over the rollforward period?

Yes. We have performed sufficient appropriate audit procedures over the information to the interim date, and this information is not part of the rollforward period information that we are predicting through our SAP.

> For example, we may audit an entity where we perform audit sampling over the first ten months of revenue. When the entity operates in a stable environment, with sales expected to be consistent throughout the period, we may be able to perform a SAP using the interim period revenue (i.e. revenue recorded from January 1 to October 31) to develop our expectation of the amount of revenue recorded from November 1 to December 31.

Examples

When may we perform a SAP over the components of a balance sheet account rollforward activity? [ISA | 1293.1700]

Fact pattern

The engagement team determines it is appropriate to perform SAPs on each of the significant components of the rollforward activity in accounts receivable during the rollforward period to address

the remaining period. They compare relevant information about the account balance at an interim date with the comparable information at period end, and do not identify any items that appear unusual.

The engagement team obtains the rollforward schedule of the accounts receivable balance activity from the interim date to period-end, and determine that the significant activity includes sales transactions (all of which are included in revenue at the date revenue is recorded in accounts receivable) and cash receipts. After testing the Completeness and Accuracy of the rollforward schedule, the engagement team perform SAPs on revenue recorded during the rollforward period and agree the revenue recorded to the accounts receivable rollforward schedule. This evidence also may serve as substantive audit evidence for revenue activity during the rollforward period. They also perform a SAP on cash receipts during the rollforward period, using information such as historical cash receipts data to predict current-period cash receipts.

Analysis

The engagement team performed sufficient audit procedures over the rollforward period assuming the level of precision is appropriate. The engagement team determine that based on the results of these procedures, in combination with other audit evidence obtained (e.g. cut-off procedures and procedures performed on the bank reconciliation at period-end), it is appropriate to extend their audit conclusions from interim through to period-end.

2 Evaluate our risk assessment and modify planned substantive procedures for contradictory evidence [ISA | 1300]

What do we do?

IF we obtain evidence that contradicts the evidence on which the original risk assessment was based, THEN evaluate the related risk assessments and modify the planned nature, timing and extent of substantive procedures for the remaining period

Why do we do this?

Contradictory evidence may affect our initial risk assessment and result in the identification of new risks of material misstatement (RMMs) or changes in the combined assessed risk (CAR) of previously identified RMMs. We modify our planned substantive procedures so that we to obtain sufficient appropriate audit evidence to address the revised RMMs or CAR.

Execute the Audit

What is contradictory evidence? [ISA | 1300.1300]

Contradictory evidence is information that contradicts management's assertions in the financial statements.

How do we modify the planned nature, timing and extent of substantive procedures for the remaining period? [ISA | 1300.1500]

To modify the planned nature, timing and extent of substantive procedures for the remaining period we may:

- alter our planned audit procedures or perform additional procedures (nature);
- perform those procedures closer to period end (timing); and/or
- select more items for testing (extent).

What if we don't modify the planned nature, timing and extent of substantive procedures for the remaining period? [ISA | 1300.10547]

If we do not modify our audit procedures the planned nature, timing and extent of substantive procedures for the remaining period, there is an increased risk that we may not address a risk of misstatement in our audit. We therefore document the facts and circumstances that led to our conclusion to evidence our thought process.

How do we evaluate our risk assessments? [ISA | 1300.10548]

We evaluate our risk assessments in accordance with 'Continue to assess RMMs, and revise audit approach as necessary'.

Adequacy of Presentation of the Financial Statements

International Standards on Auditing: ISA 330.24

Adequacy of Presentation of the Financial Statements

24. The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework. In making this evaluation, the auditor shall consider whether the financial statements are presented in a manner that reflects the appropriate:

- Classification and description of financial information and the underlying transactions, events and conditions; and
- Presentation, structure and content of the financial statements. (Ref: Para. A61)

ISA Application and Other Explanatory Material: ISA 330.A61

Adequacy of Presentation of the Financial Statements (Ref: Para. 24)

A61. Evaluating the appropriate presentation, arrangement and content of the financial statements includes, for example, consideration of the terminology used as required by the applicable financial reporting framework, the level of detail provided, the aggregation and disaggregation of amounts and the bases of amounts set forth.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Evaluate the presentation of the financial statements [ISA | 4473]

What do we do?

Evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework.

Why do we do this?

Our objective in an audit is to express an opinion on the financial statements. When management fails to disclose required information in the financial statements, there is a misstatement that could affect our opinion. If we fail to perform procedures to evaluate the presentation of the financial statements, we may issue an unqualified opinion when it is not appropriate.

Execute the Audit

What procedures do we perform to evaluate the overall presentation of the financial statements? [ISA | 4473.1300]

To evaluate the overall presentation of the financial statements, we:

- evaluate whether the financial statements are presented fairly ;
- complete the Accounting Disclosure Checklist ;
- evaluate the description of the applicable financial reporting framework .

What do we do when management fails to disclose required information in the financial statements? [ISA | 4473.1500]

When management fails to disclose required information in the financial statements, there is a misstatement. If the uncorrected misstatement is material to the financial statements, we express a qualified or adverse opinion, depending on the pervasiveness of the matter.

1.1 Evaluate whether the financial statements are presented fairly [ISA | 4474]

What do we do?

Evaluate whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

Why do we do this?

Because investors and other stakeholders rely on the financial statements, our audit work is directed toward the primary objective of determining whether the financial statements are fairly presented. Consequently, we perform procedures to evaluate whether the financial statements are fairly presented. Otherwise, we may not identify that the financial statements are not fairly presented and our reputation and the entity's could be damaged and the credibility of our audit could be undermined.

Execute the Audit

What does 'fair presentation' of the financial statements mean? [ISA | 4474.1300]

The financial statements are fairly presented when they are presented, in all material respects, in conformity with the applicable financial reporting framework. However, there may be cases where the financial statements are not fairly presented, even when they are prepared in accordance with the requirements of the financial reporting framework.

In these situations, it may be necessary for the entity to:

- include additional disclosures beyond those specifically required by the framework; or

> For example, we may identify that the entity we audit entered into a debt agreement (credit line) that stipulates that the entity will not have access to the credit line if they do not meet the working capital ratio covenant. Even though the entity met the covenant in the current period, it is possible that the financial statements would not be fairly presented unless the entity discloses that there is a condition to be able to access the credit line. This would be true even if the applicable financial reporting framework did not require specific disclosure of the covenant.

- depart from a requirement of the framework to achieve fair presentation; however, this is expected to be rare.

What is a 'financial reporting framework'?

All financial statements are prepared in accordance with a financial reporting framework.

A 'financial reporting framework' is a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements. For example, US GAAP and IFRS are commonly used financial reporting frameworks.

When do we evaluate the fair presentation of the financial statements? [ISA | 4474.1400]

We evaluate the fair presentation of the financial statement toward the end of the audit.

How do we evaluate the fair presentation of the financial statements? [ISA | 4474.1500]

Our evaluation of the fair presentation of the financial statements comprises four aspects, which include:

- Evaluate the accounting principles/policies
- Evaluate the accounting estimates
- Evaluate the information presented in the financial statements
- Evaluate the underlying transactions and events

We evaluate these four aspects taking into account the applicable financial reporting framework and the facts and circumstances of the entity.

In addition, we consult when a departure from the financial reporting framework is necessary .

1.1.1 Evaluate the accounting principles/policies [ISA | 4475]

What do we do?

Evaluate whether the accounting policies/principles selected and applied are consistent with the financial reporting framework, are appropriate in the circumstances and are appropriately disclosed, to determine whether the financial statements are presented fairly.

Why do we do this?

Investors and other stakeholders rely on the financial statements, including the disclosures. Consequently, we perform procedures to evaluate whether the financial statements are presented fairly. The evaluation of the accounting principles/policies is one of the aspects of this evaluation.

Execute the Audit

What do we evaluate regarding the accounting principles/policies when determining whether the financial statements are fairly presented? [ISA | 4475.1300]

As part of our evaluation about whether the financial statements are presented fairly in accordance with the applicable financial reporting framework, we evaluate the accounting principles/policies. In particular, we evaluate whether:

- the accounting policies/principles selected and applied are consistent with the applicable financial reporting framework;
- the accounting policies/principles selected and applied are appropriate in the circumstances of the entity; and
- the financial statements appropriately disclose the significant accounting policies selected and applied. In making this evaluation, we consider whether:
  - all disclosures related to the significant accounting policies that are required to be included by the applicable financial reporting framework have been disclosed;
  - the information about the significant accounting policies that has been disclosed is relevant to the entity;
  - the information about the significant accounting policies that has been disclosed reflects how the recognition, measurement and presentation criteria in the applicable financial reporting framework have been applied to significant accounts and disclosures; and
  - the significant accounting policies have been presented in an understandable manner - i.e. with clarity.

How do we evaluate the accounting principles/policies when determining whether the financial statements are fairly presented? [ISA | 4475.1400]

When we evaluate the accounting principles/policies to determine whether the financial statements are fairly presented, we take into account:

We take into account:	
The financial reporting framework.	We apply our professional judgment concerning the "fairness" of the presentation of the financial statements within the context of the financial reporting framework. Without the financial reporting framework, we would have no measure against which to assess the fair presentation of the financial statements. Note that, in some situations, the accounting requirements adopted by regulatory agencies for reports filed with them may differ from the financial reporting framework in certain respects.
The facts and circumstances of the entity, based on our understanding of the entity and the audit evidence obtained during the audit.	Considering the facts and circumstances of the entity (not only the financial reporting framework) is essential to evaluate fair presentation. This is because we will also think about whether: • additional disclosures beyond those specifically required by the framework are necessary to achieve fair presentation, or • a departure from a requirement of the framework is necessary to achieve fair presentation; however, this is expected to be rare.

At this point in the audit, most of our work has been performed. This serves as a final step to determine that the financial statements are fairly presented and that we are not missing anything.

1.1.2 Evaluate the accounting estimates [ISA | 4476]

What do we do?

Evaluate the reasonableness of the accounting estimates to determine whether the financial statements are presented fairly.

Why do we do this?

Investors and other stakeholders rely on the financial statements, including the disclosures. Consequently, we perform procedures to evaluate whether the financial statements are presented fairly. The evaluation of the accounting estimates is one of the aspects of this evaluation.

Execute the Audit

What do we evaluate regarding the accounting estimates when determining whether the financial statements are fairly presented? [ISA | 4476.1300]

As part of our evaluation about whether the financial statements are presented fairly in accordance with the applicable financial reporting framework, we evaluate whether the accounting estimates and related disclosures made by management are reasonable.

How do we evaluate the accounting estimates when determining whether the financial statements are fairly presented? [ISA | 4476.1400]

When we evaluate the accounting estimates and related disclosures to determine whether the financial statements are fairly presented, we take into account:

We take into account:	
The financial reporting framework.	We apply our professional judgment concerning the "fairness" of the presentation of the financial statements within the context of the financial reporting framework. Without the financial reporting framework, we would have no measure against which to assess the fair presentation of the financial statements. Note that, in some situations, the accounting requirements adopted by regulatory agencies for reports filed with them may differ from the financial reporting framework in certain respects.
The facts and circumstances of the entity, based on our understanding of the entity and the audit evidence obtained during the audit.	Considering the facts and circumstances of the entity (not only the financial reporting framework) is essential to evaluate fair presentation. This is because we will also think about whether: • additional disclosures beyond those specifically required by the framework are necessary to achieve fair presentation, or • a departure from a requirement of the framework is necessary to achieve fair

	presentation; however, this is expected to be rare.

At this point in the audit, most of our work has been performed. This serves as a final step to determine that the financial statements are fairly presented and that we are not missing anything.

1.1.3 Evaluate the information presented in the financial statements [ISA | 4477]

What do we do?

Evaluate whether the financial statements contain the information essential for a fair presentation by considering their form, arrangement, and content, to determine whether the financial statements are presented fairly.

Why do we do this?

Investors and other stakeholders rely on the financial statements, including the disclosures. Consequently, we perform procedures to evaluate whether the financial statements are presented fairly. The evaluation of the information presented in the financial statements is one of the aspects of this evaluation.

Execute the Audit

What do we evaluate regarding the information presented in the financial statements when determining whether the financial statements are fairly presented? [ISA | 4477.1300]

As part of our evaluation about whether the financial statements are presented fairly in accordance with the applicable financial reporting framework, we evaluate the information presented in the financial statements. In particular, we evaluate whether the form, arrangement and content of the financial statements are appropriate.

What we evaluate	What we consider
Form: **the format and overall structure of the information presented**	Examples of matters we consider when evaluating the form of the financial statements are: • whether the entity used the appropriate form required by the financial reporting framework; and For example, a US SEC registrant is required to use Form 10K, Form 10Q, Form 20-F, etc. • whether the entity's use of headings, subtotals and tables is appropriate and helps convey the appropriate information.

Arrangement: **the way the information is organized, ordered and presented**	Matters we consider when evaluating the arrangement of the financial statements are: • the classification of financial information and the underlying transactions, events and conditions; and • the aggregation and disaggregation of amounts. • whether the placement of significant disclosures is appropriately prominent; • whether the disclosures are appropriately labeled and cross-referenced in a manner that would facilitate users to identify the necessary information; and • whether the information is organized in a manner that is clear and easy to understand.
Content: **the information that is contained in the financial statements or the topics that are covered**	Matters we consider when evaluating the content of the financial statements are: • the description of financial information and the underlying transactions, events and conditions; • the terminology used (including the title of each financial statement) compared with what is required by the applicable financial reporting framework; • the level of detail provided - i.e. the information is summarized in a reasonable manner, that is, neither too detailed nor too condensed; • the accuracy of amounts presented; • the relevance, reliability, comparability and understandability of information presented in the financial statements; - whether all the information that should have been included has been included; - whether the information presented obscures a reader's ability to understand the matters disclosed; • the consistency of the presentation with appropriate industry practice, or whether departures are warranted due to the entity's circumstances; and • the extent to which the information in the financial statements is entity-specific and not just standard or 'boiler-plate' language. See question 'How do we determine whether the financial statement disclosures are appropriately entity-specific? ' for information on how we perform this evaluation. • whether the financial statements, including the related notes, are informative and include relevant information about matters that may affect their use, understanding and interpretation.

How do we evaluate the information presented in the financial statements when determining whether the financial statements are fairly presented? [ISA | 4477.1400]

When we evaluate the information presented in the financial statements to determine whether the financial statements are fairly presented, we take into account:

We take into account:	
The financial reporting framework.	We apply our professional judgment concerning the "fairness" of the presentation of the financial statements within the context of the financial reporting framework. Without the financial reporting framework, we would have no measure against which to assess the fair presentation of the financial statements. Note that, in some situations, the accounting requirements adopted by regulatory agencies for reports filed with them may differ from the financial reporting framework in certain respects.
The facts and circumstances of the entity, based on our understanding of the entity and the audit evidence obtained during the audit.	Considering the facts and circumstances of the entity (not only the financial reporting framework) is essential to evaluate fair presentation. This is because we will also think about whether: • additional disclosures beyond those specifically required by the framework are necessary to achieve fair presentation, or • a departure from a requirement of the framework is necessary to achieve fair presentation; however, this is expected to be rare.

How do we determine whether the financial statement disclosures are appropriately entity-specific? [ISA | 4477.1500]

The use of more standard or 'boiler-plate' language in disclosures can often be insufficient and may convey the wrong message by not properly communicating the specific circumstances of the entity. Examples of steps we may take to help us consider whether the financial statement disclosures are appropriately entity-specific are:

- use checklists, illustrative examples and other tools as a guide, not just as a checklist;

- encourage management to critically assess which information is relevant to the entity's circumstances and which information may be omitted to avoid having unnecessary information obscure necessary information;
- use our knowledge of the entity's transactions and circumstances together with professional skepticism to assess:
  - whether the disclosures of significant accounting policies are sufficiently entity-specific;

> For example, does the revenue recognition policy merely repeat what the applicable financial reporting framework indicates or does it explain how it has been applied to the entity's specific transactions?

  - whether the disclosures appropriately describe management's significant judgments and estimates, especially in sensitive areas;

> For example, revenue recognition, remuneration, impairment, going concern, subsequent events, and contingencies.

- consider whether additional disclosures, other than those required by the financial reporting framework, are necessary for the financial statements to achieve fair presentation.

1.1.4 Evaluate the underlying transactions and events [ISA | 4478]

What do we do?

Evaluate the underlying transactions and events to determine whether the financial statements are presented fairly.

Why do we do this?

Investors and other stakeholders rely on the financial statements, including the disclosures. Consequently, we perform procedures to evaluate whether the financial statements are presented fairly. The evaluation of the underlying transactions and events is one of the aspects of this evaluation.

Execute the Audit

What do we evaluate regarding the underlying transactions and events when determining whether the financial statements are fairly presented? [ISA | 4478.1300]

As part of our evaluation about whether the financial statements are presented fairly in accordance with the applicable financial reporting framework, we evaluate the underlying transactions and events. In particular, we:

- consider whether the substance of transactions or events differ materially from their form ('substance over form');

- evaluate whether the financial statements reflect the underlying transactions and events in a manner that presents the balance sheet, income statement, and cash flows, without being materially misstated;
- evaluate whether the financial statements provide adequate disclosures to enable the users to understand the effect of material transactions and events on the entity's balance sheet, income statement and cash flows.

What is the concept of 'substance over form'?

The concept of 'substance over form' is that the economic substance of transactions and events are recorded in the financial statements rather than just their legal form. This concept is intended to help achieve fair presentation.

Financial reporting frameworks usually recognize the importance of reporting transactions and events in accordance with their substance. The concept is usually embedded in the accounting principles.

When we consider 'substance over form', we determine whether a transaction is recorded to hide its true intent, which may mislead the readers of the financial statements.

	Examples
Example 1	If two entities swap their inventories, this event is not accounted as a sale - i.e. in revenue - because the *substance* is a mere in-kind exchange, despite the possible *form* of valid sales and deliveries.
Example 2	An entity transferring inventory to be used internally does not account for this event as a sale - i.e. in revenue - but it does it in a separate account.

How do we evaluate the underlying transactions and events when determining whether the financial statements are fairly presented? [ISA | 4478.1400]

When we evaluate the underlying transactions and events to determine whether the financial statements are fairly presented, we take into account:

We take into account:	
The financial reporting framework.	We apply our professional judgment concerning the "fairness" of the presentation of the financial statements within the context of the financial reporting framework. Without the financial reporting framework, we would have no measure against which to assess the fair presentation of the financial statements. Note that, in some situations, the accounting requirements adopted by regulatory agencies

	for reports filed with them may differ from the financial reporting framework in certain respects.
The facts and circumstances of the entity, based on our understanding of the entity and the audit evidence obtained during the audit.	Considering the facts and circumstances of the entity (not only the financial reporting framework) is essential to evaluate fair presentation. This is because we will also think about whether: • additional disclosures beyond those specifically required by the framework are necessary to achieve fair presentation, or • a departure from a requirement of the framework is necessary to achieve fair presentation; however, this is expected to be rare.

At this point in the audit, most of our work has been performed. This serves as a final step to determine that the financial statements are fairly presented and that we are not missing anything.

1.1.5 Consult when a departure from the financial reporting framework is necessary [ISA | 7658]

What do we do?

Consult when a departure from the applicable financial reporting framework is necessary.

Why do we do this?

We consult when a departure from the applicable financial reporting framework is necessary to achieve fair presentation because this is supposed to be a rare situation. The party consulted may help us determine the appropriate course of action.

Execute the audit

What do we do if the entity is in the rare circumstance in which a departure from the applicable financial reporting framework is necessary to achieve fair presentation (also referred as a true and fair override)? [ISA | 7658.14096]

We consult with DPP if the entity is in the rare circumstance in which a departure from the applicable financial reporting framework is necessary to achieve fair presentation (sometimes referred as a true and fair override). We also consult with the ISG if the financial reporting framework is IFRS or another framework that is generally recognized as being based on IFRSs.

1.2 Complete the Accounting Disclosure Checklist

[ISA | 4479]

What do we do?

Complete the Accounting Disclosure Checklist for the applicable financial reporting framework.

Why do we do this?

The Accounting Disclosure Checklist is a useful tool in our evaluation of whether the financial statements contain the information essential for a fair presentation in conformity with the applicable financial reporting framework.

Execute the Audit

What is the Accounting Disclosure Checklist? [ISA | 4479.1300]

The Accounting Disclosure Checklist (ADC) is a useful tool that is used as a guide or 'memory jogger' to help highlight the disclosures required by the applicable financial reporting framework. There may be more than one ADC to complete, depending on the industry and the client's business.

Note that we audit the significant disclosures throughout the audit, the same way we audit the significant accounts. However, at the end of the audit, we use the ADC to help us determine that all the disclosures required by the applicable financial reporting framework are included in the financial statements and we are not missing anything.

Do we always complete the Accounting Disclosure Checklist? [ISA | 4479.13946]

It depends. When US GAAP is the applicable financial reporting framework, the US Accounting Disclosure Checklist is completed. For all other applicable financial reporting frameworks, an Accounting Disclosure Checklist is completed when required by local policy.

Is completing the Accounting Disclosure Checklist sufficient to evaluate fairness of presentation? [ISA | 4479.13945]

No. Completing the Accounting Disclosure Checklist is not sufficient for evaluating fairness of presentation. While the work paper may help serve as a completeness check to evaluate whether the required disclosures are present, it does not replace professional judgment in determining necessary disclosures (see activity 'Evaluate whether the financial statements are presented fairly' for further information).

1.3 Evaluate the description of the applicable financial reporting framework [ISA | 4483]

What do we do?

Evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.

Why do we do this?

Financial statements that are fairly presented refer to or describe the applicable financial reporting framework. This helps the users to identify the framework on which the financial statements are based.

Execute the Audit

How do we evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework? [ISA | 4483.1300]

There are two things we think about to determine whether the description of the applicable financial reporting framework is adequate:

	Explanation
Precise language	A description of the applicable financial reporting framework that contains imprecise, qualifying or limiting language is not an adequate description of that framework as it may mislead users of the financial statements. Examples of imprecise, qualifying or limiting language are "the financial statements are in substantial compliance with IFRS" or "the financial statements are in compliance with the accounting requirements of IFRS".
Financial statements comply with all requirements of the framework	A description that the financial statements are prepared in accordance with a particular financial reporting framework is appropriate only if the financial statements comply with all the requirements of that framework that are effective during the period covered by the financial statements.

Is a reference to more than one financial reporting framework possible and likely? [ISA | 4483.1400]

It is possible but not likely. The financial statements may represent that they are prepared in accordance with *two* financial reporting frameworks. However, in practice, this is unlikely because a reference to more than one financial reporting framework is appropriate only if the financial statements comply with each of the frameworks individually and no reconciling statements are necessary.

Financial statements that are prepared in accordance with one financial reporting framework and that contain a note or supplementary statement reconciling the results to those that would be shown under another framework, are not prepared in accordance with that other framework. This is because the financial statements do not include all the information in the manner required by that other framework.

The financial statements may instead, represent that they are prepared in accordance with *one* applicable financial reporting framework and, in addition, describe in the notes to the financial statements the extent to which the financial statements comply with another framework.

What do we do when the note to the financial statements describing the extent to which they comply with another framework is misleading? [ISA | 4483.1500]

When reporting on financial statements prepared in accordance with a national financial reporting framework that also disclose the extent to which the financial statements comply with IFRS, we consult with DPP and the risk management partner if such disclosure is misleading.

Evaluating the Sufficiency and Appropriateness of Audit Evidence

International Standards on Auditing: ISA 330.25-27

Evaluating the Sufficiency and Appropriateness of Audit Evidence

25. Based on the audit procedures performed and the audit evidence obtained, the auditor shall evaluate before the conclusion of the audit whether the assessments of the risks of material misstatement at the assertion level remain appropriate. (Ref: Para. A62-A63)

26. The auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements. (Ref: Para. A64)

27. If the auditor has not obtained sufficient appropriate audit evidence related to a relevant assertion about a class of transactions, account balance or disclosure, the auditor shall attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements.

ISA Application and Other Explanatory Material: ISA 330.A62-A64

Evaluating the Sufficiency and Appropriateness of Audit Evidence (Ref: Para. 25-27)

A62. An audit of financial statements is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing or extent of other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example:

- The extent of misstatements that the auditor detects by performing substantive procedures may alter the auditor's judgment about the risk assessments and may indicate a significant deficiency in internal control.

- The auditor may become aware of discrepancies in accounting records, or conflicting or missing evidence.
- Analytical procedures performed at the overall review stage of the audit may indicate a previously unrecognized risk of material misstatement.

In such circumstances, the auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks of material misstatement and the effect on the significant classes of transactions, account balances, or disclosures and their relevant assertions. ISA 315 (Revised 2019) contains further guidance on revising the auditor's risk assessment.[7]

_____

7 ISA 315 (Revised 2019), paragraph 53

A63. The auditor cannot assume that an instance of fraud or error is an isolated occurrence. Therefore, the consideration of how the detection of a misstatement affects the assessed risks of material misstatement is important in determining whether the assessment remains appropriate.

A64. The auditor's judgment as to what constitutes sufficient appropriate audit evidence is influenced by such factors as the following:

- Significance of the potential misstatement in the assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements.
- Effectiveness of management's responses and controls to address the risks.
- Experience gained during previous audits with respect to similar potential misstatements.
- Results of audit procedures performed, including whether such audit procedures identified specific instances of fraud or error.
- Source and reliability of the available information.
- Persuasiveness of the audit evidence.
- Understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Evaluate the sufficiency and appropriateness of audit evidence [ISA | 4484]

What do we do?

Evaluate the sufficiency and appropriateness of audit evidence.

Why do we do this?

Our objective in an audit is to express an opinion on the financial statements. Obtaining sufficient appropriate audit evidence of whether the financial statement are free of material misstatement is essential for us to express our opinion.

Execute the Audit

Enhanced | How do we evaluate the sufficiency and appropriateness of audit evidence? [ISA | 4484.1400]

We evaluate the sufficiency and appropriateness of audit evidence by performing the following activities:

- Evaluate whether the risk assessments remain appropriate ;
- Hold a RAQA meeting and document the details ;
- Conclude on whether sufficient appropriate audit evidence has been obtained ;
- Take into account all relevant audit evidence when forming an opinion ; and
- Obtain further audit evidence when applicable .

Core and Less Complex | How do we evaluate the sufficiency and appropriateness of audit evidence? [ISA | 4484.1500]

We evaluate the sufficiency and appropriateness of audit evidence by performing the following activities:

- Evaluate whether the risk assessments remain appropriate ;
- Conclude on whether sufficient appropriate audit evidence has been obtained ;
- Take into account all relevant audit evidence when forming an opinion ; and
- Obtain further audit evidence when applicable .

As part of these activities, the engagement partner determines whether to hold a RAQA meeting (see activity 'Hold a RAQA meeting and document the details, if applicable ').

1.1 Evaluate whether the risk assessments remain appropriate [ISA | 4487]

What do we do?

Evaluate whether the assessments of the risks of material misstatement and our CARs remain appropriate and whether additional procedures are necessary.

Why do we do this?

Identifying and assessing risks is a continuous activity that occurs throughout every phase of the audit and can affect and better inform our initial risk assessments.

Execute the Audit

When do we evaluate whether the assessments of the RMMs at the assertion level remain appropriate? [ISA | 4487.15813]

Evidence that we gather throughout our audit, e.g. while testing controls or performing substantive procedures, can affect and better inform our initial risk assessments. Information may come to our attention that differs significantly from the information on which our risk assessments were based. As a result, we may identify new risks or modify previously identified risks and/or modify our CAR

assessments. See activity 'Continue to assess RMMs, and revise audit approach as necessary ' for further information on re-assessing risks throughout the audit.

During our concluding procedures, we have an opportunity to ask ourselves, one last time, whether we have identified, assessed and appropriately addressed all the risks of material misstatement in the audit. This is our final chance to re-evaluate our risk assessments as we are evaluating the collective results of our procedures.

1.2.C Core and Less Complex | Hold a RAQA meeting and document the details, if applicable [ISA | 4586]

What do we do?

IF the engagement partner decides to hold a Risk and Audit Quality Assessment meeting, THEN hold the meeting and document: a) date, b) participants, c) topics discussed, and d) reference(s) to documentation associated with revisions to our further audit procedures.

Why do we do this?

The Risk and Audit Quality Assessment (RAQA) meeting provides an opportunity to gather engagement team members at the end of the audit to collectively discuss important topics that can have implications on the quality of our audit and our audit opinion.

Execute the Audit

Core and Less Complex | What is the RAQA meeting? [ISA | 4586.1300]

The RAQA meeting is not a 'check the box' exercise. We gather the engagement team members together one last time in our audit to:

- share relevant and critical information gained during the audit across the team and
- collectively analyze what we know about the entity and the work performed to:
  - determine that we did not miss any risk and we addressed all identified risks adequately;
  - consider the evidence obtained, judgments made and conclusions reached; and
  - determine that the documentation prepared is adequate.

During the meeting, everyone's input is important and is most effective when everyone is engaged.

Core and Less Complex | How does the engagement partner decide whether to hold a RAQA meeting? [ISA | 4586.1400]

The engagement partner uses his or her discretion to decide whether to hold a RAQA meeting. The communication of relevant matters may be conducted informally throughout the audit, as needed, or formally during a RAQA meeting. Either approach is acceptable.

Core and Less Complex | What is the difference between the RAPD and the RAQA meetings? [ISA | 4586.1500]

The focus in the RAQA meeting is not on planning but on thinking about what we did during the audit, what we now know about the entity, and the results we obtained and what that tells us. Especially the sufficiency and appropriateness of evidence we have accumulated.

Core and Less Complex | When do we conduct the RAQA meeting? [ISA | 4586.1600]

We schedule the RAQA meeting far enough in advance of the date of the auditor's report to allow us sufficient time to address any issues that we may identify during the meeting. Schedule the meeting on the same day we plan to date our report may not allow us sufficient time.

Core and Less Complex | Who participates in the RAQA meeting? [ISA | 4586.1700]

The engagement partner ordinarily determines who will participate in the RAQA meeting by using professional judgment, prior experience with the entity and knowledge of key areas in the audit. It is recommended that participants include:

- engagement team members, including specific team members (e.g. IT Audit or tax) and employed KPMG specialists, who performed or reviewed audit procedures over risks of material misstatements;
- other auditors involved in the audit of other locations or business units; and
- engaged KPMG specialists.

Core and Less Complex | Group Audits | Do component auditors participate in the RAQA meeting? [ISA | 4586.159683]

The group engagement partner may request that the component auditor participate in the RAQA meeting to include the component auditors throughout the audit regarding information or conditions that are indicative of fraud risks. This communication can, however, also be in the form of other effective two-way communication between the group auditor and the component auditor, for example,

via the communications in the Group Audit Instructions and the related templates or the group auditor visiting the component auditor during the audit and holding in-person discussions regarding information or conditions that are indicative of fraud risks.

Core and Less Complex | What if participants cannot participate in-person? [ISA | 4586.1800]

Similar to the RAPD meeting, when key engagement team members are not able to participate in-person or there are team members located in multiple locations, we may try to carry out the meeting using:

- conference calls;
- video-conferencing; or
- some combination of both, with some locations participating by conference call and others by video.

These technology solutions can enable the right people to be involved in the meeting.

Core and Less Complex | What are example agenda items for the RAQA meeting? [ISA | 4586.15842]

Engagement teams develop the RAQA meeting agenda based on their own facts and circumstances, however, the following are example agenda items for the RAQA meeting:

Example agenda items for the RAQA meeting
• risks of material misstatement that are significant, including fraud risks: - summary of risks - discuss how risk(s) were addressed - discuss whether the results of audit procedures indicate previously unidentified risks - discuss matters that might affect our assessment of fraud risks - communications within the engagement team members throughout the audit regarding information or conditions that indicate fraud risks - have communications been appropriate? - involvement and conclusions reached by specific team members (e.g. IT Audit or tax), and specialists. - discuss contradictory or inconsistent evidence identified • materiality - is it necessary to reassess materiality or performance materiality? • significant accounts that contain an estimate(s) - changes in management's estimation process - indicators of management bias - trigger events for evaluation of goodwill, intangible assets or long-lived assets impairment • significant or unusual related party transactions • significant unusual transactions • risk assessments for multiple locations or business units, and the results of audit procedures performed by other independent auditors

- control deficiencies
  - nature and severity of control deficiencies
  - implications on our CAR assessments, audit procedures, and communications to management and those charged with governance
- summary of audit misstatements
  - underlying cause(s) of misstatements
  - implications of those misstatements on other audit areas (including the entity's internal controls, reporting and communications to those charged with governance)
  - changes to our planned audit approach
- consultations
- actual or suspected illegal acts or fraud
- other matters to communicate to those charged with governance
- other significant findings and issues
- audit quality - reinforce importance of audit quality, professional skepticism and our role in protecting capital markets and public interest
- ethics and integrity
  - discuss how the firm's standards of ethics and integrity were met, or if there were any issues or difficulties encountered.
  - discuss how our values and culture were upheld, or if there were any issues or difficulties encountered.

1.2.E Enhanced | Hold a RAQA meeting and document the details [ISA | 4488]

What do we do?

Hold a Risk and Audit Quality Assessment meeting and document: a) date, b) participants, c) topics discussed, and d) reference(s) to documentation associated with revisions to our further audit procedures.

Why do we do this?

The Risk and Audit Quality Assessment (RAQA) meeting provides an opportunity to gather engagement team members at the end of the audit to collectively discuss important topics that can have implications on the quality of our audit and our audit opinion.

Execute the Audit

Enhanced | What is the RAQA meeting? [ISA | 4488.1300]

The RAQA meeting is not a 'check the box' exercise. We gather the engagement team members together one last time in our audit to:

- share relevant and critical information gained during the audit across the team, and

- collectively analyze what we know about the entity and the work performed to:
  - determine that we did not miss any risk and we addressed all identified risks adequately;
  - consider the evidence obtained, judgments made and conclusions reached; and
  - determine that the documentation prepared is adequate.

During the meeting, everyone's input is important and the meeting is most effective when everyone is engaged.

Enhanced | What is the difference between the RAPD and the RAQA meetings? [ISA | 4488.1400]

The focus in the RAQA meeting is not on planning, but on thinking about what we did during the audit, what we now know about the entity and the results we obtained and what that tells us. Especially the sufficiency and appropriateness of evidence we have accumulated.

Enhanced | When do we conduct the RAQA meeting? [ISA | 4488.1500]

We schedule the RAQA meeting far enough in advance of the date of the auditor's report to allow us sufficient time to address any issues that we may identify during the meeting. Schedule the meeting on the same day we plan to date our report may not allow us sufficient time.

Enhanced | Who participates in the RAQA meeting? [ISA | 4488.1600]

The engagement partner ordinarily determines who will participate in the RAQA meeting by using professional judgment, prior experience with the entity and knowledge of key areas in the audit. It is recommended that participants include:

- engagement team members, including specific team members (e.g. IT Audit or tax) and employed KPMG specialists, who performed or reviewed audit procedures over risks of material misstatements;
- other auditors involved in the audit of other locations or business units; and
- engaged KPMG specialists.

Enhanced | Group Audits | Do component auditors participate in the RAQA meeting? [ISA | 4488.159682]

The group engagement partner may request that the component auditor participate in the RAQA meeting to include the component auditors throughout the audit regarding information or conditions that are indicative of fraud risks. This communication can, however, also be in the form of other effective two-way communication between the group auditor and the component auditor, for example, via the communications in the Group Audit Instructions and the related templates or the group auditor visiting the component auditor during the audit and holding in-person discussions regarding information or conditions that are indicative of fraud risks.

Enhanced | What if participants cannot participate in-person? [ISA | 4488.15852]

Similar to the RAPD meeting, when key engagement team members are not able to participate in-person or there are team members located in multiple locations, we may try to carry out the meeting using:

- conference calls;
- video-conferencing; or
- some combination of both, with some locations participating by conference call and others by video.

These technology solutions can enable the right people to be involved in the meeting.

Enhanced | What are example agenda items for the RAQA meeting? [ISA | 4488.15853]

Engagement teams develop the RAQA meeting agenda based on their own facts and circumstances; however, the following are example agenda items for the RAQA meeting:

Example agenda items for the RAQA meeting

- risks of material misstatement that are significant, including fraud risks:
  - summary of risks
  - discuss how risk(s) were addressed
  - discuss whether the results of audit procedures indicate previously unidentified risks
  - discuss matters that might affect our assessment of fraud risks
  - communications within the engagement team members throughout the audit regarding information or conditions that indicate fraud risks - have communications been appropriate?
  - involvement and conclusions reached by specific team members (e.g. IT Audit or tax) and specialists
  - discuss contradictory or inconsistent evidence identified
- materiality - is it necessary to reassess materiality or performance materiality?
- significant accounts that contain an estimate(s)
  - changes in management's estimation process
  - indicators of management bias
  - trigger events for evaluation of goodwill, intangible assets or long-lived assets impairment
- significant or unusual related party transactions
- significant unusual transactions
- risk assessments for multiple locations or business units, and the results of audit procedures performed by other independent auditors
- control deficiencies
  - nature and severity of control deficiencies
  - implications on our CAR assessments, audit procedures, and communications to management and those charged with governance
- summary of audit misstatements
  - underlying cause(s) of misstatements
  - implications of those misstatements on other audit areas (including the entity's internal controls, reporting and communications to those charged with governance)
  - changes to our planned audit approach
- consultations

- actual or suspected illegal acts or fraud
- other matters to communicate to those charged with governance
- other significant findings and issues
- audit quality - reinforce importance of audit quality, professional skepticism and our role in protecting capital markets and public interest
- ethics and integrity

  - discuss how the firm's standards of ethics and integrity were met, or if there were any issues or difficulties encountered.

  - discuss how our values and culture were upheld, or if there were any issues or difficulties encountered.

1.3 Conclude on whether sufficient appropriate audit evidence has been obtained [ISA | 4485]

What do we do?

Conclude on whether sufficient appropriate audit evidence has been obtained.

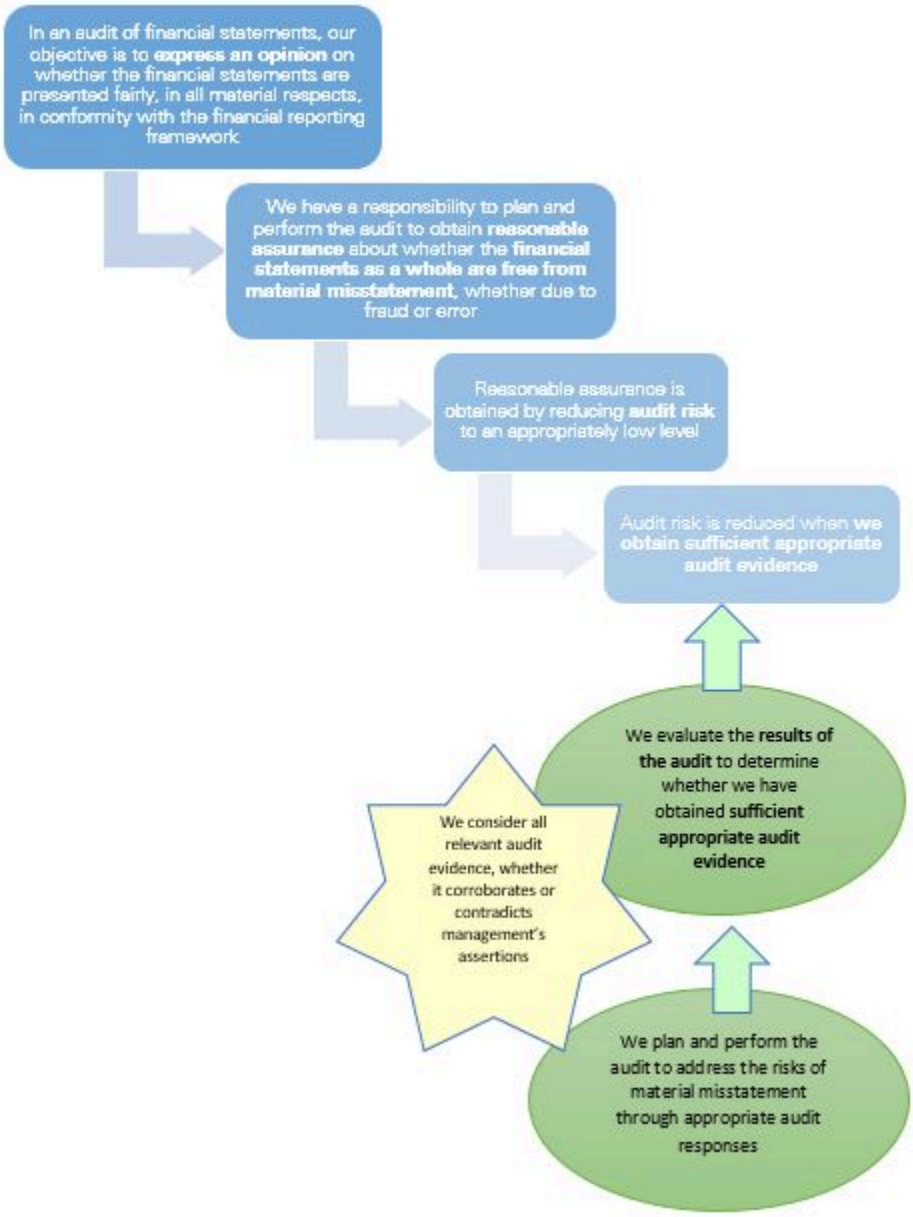
Why do we do this?

Our objective in an audit is to express an opinion on the financial statements. Obtaining sufficient appropriate audit evidence of whether the financial statements are free of material misstatement is essential for us to express our opinion. When we conclude on whether sufficient appropriate audit evidence has been obtained, we are confirming our belief that audit risk has been reduced to an appropriately low level.

Execute the Audit

How does concluding whether we have obtained sufficient appropriate audit evidence help us express the audit opinion? [ISA | 4485.1300]

The diagram below shows how evaluating the results of the audit to determine whether we have obtained sufficient appropriate audit evidence helps us achieve our objective - to form and express the right audit opinion on the financial statements. The blue shapes represent our professional responsibilities. The green shapes represent what we do to execute those professional responsibilities.



If we fail to obtain audit evidence, there is a possibility that our unqualified opinion will not be appropriate or properly supported.

What is the difference between considering the audit evidence throughout the audit and toward the end of the audit? [ISA | 4485.1400]

Throughout the audit, we make specific conclusions about whether sufficient appropriate audit evidence has been obtained for each risk of material misstatement (RMM) and relevant financial statement assertion. As we perform our individual audit procedures, our focus tends to be on the results of each audit procedure and on whether we obtained sufficient appropriate audit evidence for a particular RMM and/or assertion.

However, at the end of the audit, we also consider the sufficiency and appropriateness of our audit evidence collectively.

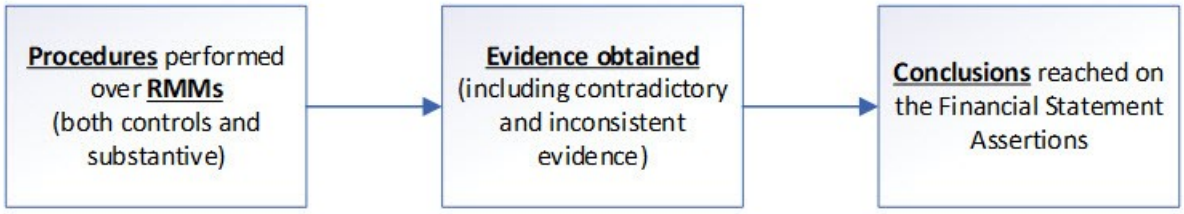
Imagine we are standing in the middle of a forest, where we can examine each tree individually or in small groups. In contrast, if we are in a helicopter, we are able to look at all trees at the same time and have a better idea of what the forest looks like overall.

This is similar to what happens in an audit. We can analyze the audit evidence obtained over each risk of material misstatement for a significant account or disclosure (a tree or group of trees). However, unless we take a step back and look at all the audit evidence we obtained overall (the forest), we may not properly consider whether we have sufficient appropriate audit evidence to support our opinion.

How do we conclude, throughout the audit, on whether sufficient appropriate audit evidence has been obtained? [ISA | 4485.1500]

Throughout the audit, we make specific conclusions about whether sufficient appropriate audit evidence has been obtained for each relevant financial statement assertion.

We obtain sufficient appropriate audit evidence performing audit procedures to address each of the RMMs related to a particular assertion. This diagram illustrates how we clearly connect the procedures performed and evidence obtained at the RMM level with the conclusions reached at the relevant assertion level:

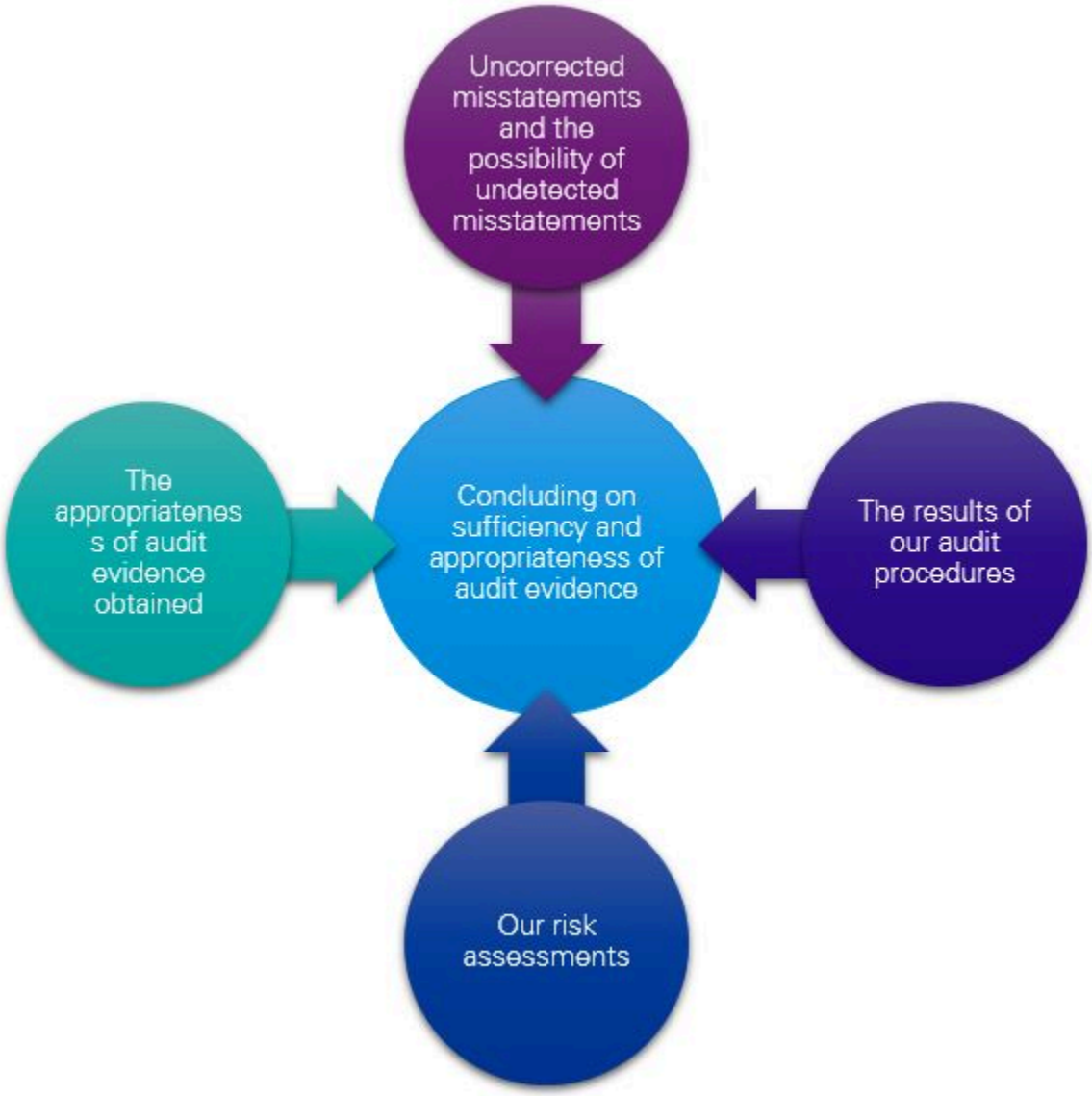


We respond to each RMM related to a particular assertion and then conclude whether the relevant assertion has been addressed overall. By documenting our procedures performed and evidence obtained for the RMMs identified, our documentation will clearly reflect our work and conclusions reached for each relevant assertion to which the RMMs relate.

How do we conclude, toward the end of the audit, on whether sufficient appropriate audit evidence has been obtained? [ISA | 4485.1600]

As part of our concluding procedures, we consider the audit evidence obtained in aggregate. In particular, we consider the following factors and weigh them together:

- The significance of uncorrected misstatements, along with the possibility of further undetected misstatements, and the likelihood of their having a material effect on the financial statements.
- The results of audit procedures performed in the audit of financial statements, including whether the evidence obtained supports or contradicts management's assertions and whether such audit procedures identified specific instances of fraud.
- Our risk assessments.
- The results of audit procedures performed in the audit of internal control over financial reporting, if the audit is an integrated audit.
- The appropriateness (i.e., the relevance and reliability) of the audit evidence obtained.



While we may have felt satisfied with the results of each procedure individually, thinking about them together may help us identify areas or elements of the audit evidence where we have concerns about the sufficiency of the audit evidence in total.

Identifying potential contradictory or inconsistent evidence plays a major part in our considerations.

> For example, when we are considering the results of the audit procedures in aggregate, we notice that the entity used two different sets of income and cash flow projections to evaluate the recoverability of deferred income tax balances and goodwill.
>
> This fact may raise concerns about whether we have reasonable assurance that the financial statements are free of material misstatement.

Group Audit | What are the additional considerations when we evaluate whether sufficient appropriate audit evidence has been obtained in a group audit? [ISA | 4485.15847]

As the group auditor, when, toward the end of the audit, we evaluate whether sufficient appropriate audit evidence has been obtained, we also consider information obtained from the work performed by component auditors and our communications with them when evaluating those factors (e.g. misstatements identified by component auditors, results of audit procedures performed, their risk assessments, etc.).

Do accounting records alone provide sufficient appropriate audit evidence on which to base an audit opinion on the financial statements? [ISA | 4485.8707]

While we may determine that the accounting records are internally consistent and agree to the financial statements, ordinarily accounting records alone do not provide sufficient appropriate audit evidence on which to base an audit opinion on the financial statements.

1.4 Take into account all relevant audit evidence when forming an opinion [ISA | 4423]

What do we do?

Take into account all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements.

Why do we do this?

We accumulate audit evidence throughout the audit. This evidence can corroborate or contradict management's assertions in the financial statements. Appropriately considering all relevant audit evidence is the hallmark of exercising professional skepticism. If we fail to appropriately consider all relevant audit evidence, we may reach the wrong audit conclusions and issue the wrong opinion.

Execute the Audit

What is contradictory evidence? [ISA | 4423.1300]

Contradictory evidence is information that contradicts management's assertions in the financial statements.

When do we consider contradictory evidence? [ISA | 4423.1400]

We consider contradictory evidence

- throughout the audit when we evaluate the information to be used as audit evidence; and
- towards the end of the audit when we are concluding whether we have obtained sufficient appropriate audit evidence to form an opinion.

Therefore, toward the end of the audit, we think critically about all the areas of our audit and all of the evidence we have gathered because it provides an additional opportunity to identify and follow up on evidence that may be contradictory.

We reach our final conclusions and issue our audit opinion *after* we have addressed and resolved any contradictory evidence.

How do we consider contradictory evidence? [ISA | 4423.1500]

Consideration of evidence that appears to contradict management's assertions may not always be easy. This can be more challenging on a larger audit that includes numerous team members or locations.

Contradictory information is not considered in isolation but, rather, as part of our consideration with respect to that management assertion taken as a whole. In such cases, professional skepticism and judgment is necessary to evaluate the persuasiveness of the audit evidence taken as a whole, rather than focusing on an individual piece of audit evidence.

In forming our opinion, we take into account all relevant information to be used as audit evidence, regardless of whether it:

- appears to corroborate or to contradict the assertions in the financial statements
- is consistent with other audit evidence obtained.

This includes sampling, where we relate the evaluation of a sample to other relevant audit evidence when forming a conclusion about the related account balance.

> For example, the engagement team may become aware of information on social media suggesting the entity's product has major quality issues and that all buyers would be returning the product. The engagement team has obtained external confirmations regarding product sales and outstanding accounts receivable that do not indicate quality or return issues and has scanned the sales returns subsidiary ledger, which contained only an immaterial amount of returns subsequent to year-end. In light of that, the engagement team concludes that the contradictory information does not suggest a reasonable possibility of a risk of material misstatement and that further audit procedures are not necessary.

What do we do when we identify contradictory evidence? [ISA | 4423.15819]

When we identify contradictory evidence, we consider the effect on our audit through determining:

- the necessary procedures to address the matter properly; and
- the effect, if any, on other aspects of the audit.

> For example, audit evidence we obtained through the inspection of an original document may corroborate a financial statement assertion, whereas audit evidence obtained from confirmation with an external party may contradict that financial statement assertion. In this case, additional audit evidence may be necessary for us to conclude on the relevant assertion.

Why do we include contradictory evidence in our audit documentation? [ISA | 4423.15820]

Including contradictory evidence and how we resolved the matter in our audit documentation:

- helps us demonstrate effectively how we addressed the matter during the audit; and
- provides an opportunity to demonstrate we have exercised professional skepticism.

Example

What procedures may an engagement team perform when identifying contradictory evidence? [ISA | 4423.1600]

Fact Pattern

The engagement team is performing procedures over the completeness and accuracy of the legal reserve. As part of these procedures, they:

- understand the process the entity follows to determine the legal reserve;
- inquire of management, who indicates that a claim from Company X is the only known claim filed by Company X;
- perform procedures over the estimated amount the entity expects to pay out if Company X's claim is resolved unfavorably.

During the review of the Board of Directors meeting minutes, the engagement team observes that there is discussion indicating that Company X may file an additional claim.

Analysis

The Board of Directors meeting minutes represent information that appears to contradict management's assertions with respect to the legal reserves - i.e. that the selected claim from Company X was the only known claim. Therefore, the engagement team investigates the matter further.

The engagement team ultimately concludes that while the entity received information that indicates Company X may file an additional claim, no claim had yet been filed and the entity did not have any additional information to allow them to estimate a reserve for such a claim.

The engagement team includes the meeting minutes and the procedures performed to investigate the potential additional claim in their audit documentation related to the legal reserves.

1.5 Obtain further audit evidence when applicable

[ISA | 4486]

What do we do?

IF we have not obtained sufficient appropriate audit evidence, **THEN** perform procedures to obtain further audit evidence.

Why do we do this?

Whenever we, as the auditor in a stand-alone audit or as the group auditor, determine that we do not have sufficient appropriate audit evidence, we perform additional audit procedures. This is the last chance we have in the audit to gather all the audit evidence necessary to support our opinion.

Execute the Audit

Group Audit | What are the considerations in a group audit when sufficient appropriate audit evidence has not been obtained? [ISA | 4486.1300]

As the group auditor, when we have not obtained sufficient appropriate audit evidence, we may request the component auditor to perform the relevant additional procedures on a component. If it is not feasible for the component auditor to perform the additional procedures, we may perform our own procedures to obtain sufficient appropriate audit evidence.

What do we do when we are unable to obtain sufficient appropriate audit evidence after performing additional procedures? [ISA | 4486.1400]

When we are unable to obtain sufficient appropriate audit evidence after performing additional procedures, we express a qualified opinion or a disclaimer of opinion, depending on the pervasiveness of the matter.

Example

How does an engagement team perform additional procedures to obtain sufficient appropriate audit evidence? [ISA | 4486.1500]

Fact pattern

At the end of the audit, the engagement team is considering the results of the audit procedures in aggregate and notices that the entity used two different sets of income and cash flow projections to evaluate the recoverability of deferred income tax balances and goodwill.

Analysis

This fact raises concerns about whether the engagement team has sufficient appropriate audit evidence.

Because these projections are potentially contradictory, the engagement team performs a variety of additional procedures to address the matter, including:

- inquiring of management about the reason for the two sets of projections;
- corroborating the information within the projections with:
  - the budget/strategic plan from the entity's internal financial analysis team - e.g. Financial Planning and Analysis, or FP&A, department;
  - projections or guidance released to investors;
  - information presented to and approved by the Board of Directors - e.g. the annual budget or strategic plan; and/or
  - relevant industry data;
- evaluating whether the projections affect the conclusions reached or assertions made by management - e.g. do the alternative projections result in an impairment conclusion or suggest additional impairment may need to be recorded?; and
- evaluating whether using two sets of projections indicates a broader or deeper problem - e.g. management bias or fraud.

Documentation

International Standards on Auditing: ISA 330.28-30

Documentation

28. The auditor shall include in the audit documentation:[2]

(a) The overall responses to address the assessed risks of material misstatement at the financial statement level, and the nature, timing and extent of the further audit procedures performed;

(b) The linkage of those procedures with the assessed risks at the assertion level; and

(c) The results of the audit procedures, including the conclusions where these are not otherwise clear. (Ref: Para. A65)

_____

2 ISA 230, *Audit Documentation,* paragraphs 8 - 11, and A6

29. If the auditor plans to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor shall include in the audit documentation the conclusions reached about relying on such controls that were tested in a previous audit.

30. The auditor's documentation shall demonstrate that information in the financial statements agrees or reconciles with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers.

ISA Application and Other Explanatory Material: ISA 330.A65

Documentation (Ref: Para. 28)

A65. The form and extent of audit documentation is a matter of professional judgment, and is influenced by the nature, size and complexity of the entity and its system of internal control, availability of information from the entity and the audit methodology and technology used in the audit.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Document planning and risk assessment activities [ISA | 1645]

What do we do?

Prepare audit documentation to clearly evidence planning and risk assessment activities

Why do we do this?

In preparing the audit documentation, we document a summary of the identified RMMs and our assessment of the CAR, and our assessment of financial statement level risks, in order to properly evidence how the procedures performed, including control testing, and conclusions reached appropriately respond to the RMMs identified.

Execute the Audit

What information relative to the risks identified and responses to those risks do we include in our audit documentation? [ISA | 1645.1400]

Our audit documentation specifically includes:

- A summary of the identified and assessed risks of material misstatement at both the assertion level and financial statement 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;
- Our audit responses with a linkage back to the risks of material misstatement. This includes tests of controls, overall responses and substantive procedures; and
- Conclusions reached related to those audit procedures (e.g. effective/ineffective controls, misstatements identified, if substantive test was achieved).

How do we document the information about the risks identified and our response as part of our audit? [ISA | 1645.1500]

KPMG Clara workflow facilitates the documentation of risks as part of our risk assessment process and audit planning (to identify and assess risks and connect RMMs to our planned responses) and as our procedures are performed (we document the conclusions reached in relation to the procedures performed).

2 Design and implement overall responses [ISA | 782]

What do we do?

Design and implement overall responses to address the risks of material misstatement

Why do we do this?

Overall responses lay the foundation for the rest of our audit procedures. They also act together with our assertion-level responses to help us obtain sufficient appropriate audit evidence. Overall responses affect how the overall audit is conducted and performed. Whereas, assertion-level responses relate to the nature, timing and extent of the procedures we perform over each assertion-level RMM.

If we fail to design and implement an appropriate overall response to the audit, our assertion-level responses are unlikely to meet our audit objective.

Execute the Audit

What are overall responses? [ISA | 782.1300]

We may design and implement two different types of overall responses.

Type of response	Responses
General overall responses	• Assigning significant engagement responsibilities appropriately • Providing appropriate supervision • Selecting audit procedures with elements of unpredictability

	• Evaluating the entity's selection and application of significant accounting policies or principles
Other overall responses - e.g. how we respond to identified pervasive financial statement-level risks	• Making pervasive or general changes to the nature, timing and extent of our audit procedures

When do we design and implement overall responses? [ISA | 782.11520]

We always perform the following overall responses to respond to the assessed risks of material misstatement on every audit, regardless of whether we have identified an entity specific financial statement level risk or not:

- Making appropriate assignments of significant engagement responsibilities. The knowledge, skill, and ability of engagement team members with significant engagement responsibilities is to be commensurate with the assessed risks of material misstatement.
- Providing the extent of supervision that is appropriate for the circumstances, including, in particular, the assessed risks of material misstatement.
- Incorporating elements of unpredictability in the selection of audit procedures to be performed. As part of our response to the assessed risks of material misstatement, including the assessed fraud risks, we incorporate an element of unpredictability in the selection of auditing procedures to be performed from year to year.
- Evaluating the entity's selection and application of significant accounting policies or principles. We evaluate whether the entity's selection and application of significant accounting policies or principles, particularly those related to subjective measurements and complex transactions, are indicative of bias that could lead to material misstatement of the financial statements.

Overall responses can also help us address risks of material misstatement at the financial statement level and **assertion-level**.

Can a specific overall response address multiple financial statement level risks?

Yes.

What effect might the control environment have on our overall responses? [ISA | 782.11521]

An effective control environment may allow us to have more confidence in both internal controls and the reliability of audit evidence generated within the entity.

This can affect our assessment of RMMs and how we respond to them. For example, we may be able to perform some audit procedures at an interim date rather than at the period end.

Deficiencies in the control environment, however, have the opposite effect. For example, we may respond to an ineffective control environment by:

- conducting more audit procedures as of the period end rather than at an interim date;
- obtaining more extensive audit evidence from substantive procedures; and/or
- including more locations in the scope of our audit.

Such considerations, therefore, have a significant bearing on our general approach - for example, whether we take:

- a substantive approach - i.e. placing an emphasis on substantive procedures; or
- a combined approach - i.e. using tests of controls as well as substantive procedures.

How are overall responses different from assertion-level responses? [ISA | 782.1500]

Overall responses affect how we conduct the audit broadly. Assertion-level responses are more specific than overall responses, as they focus on tests of controls and substantive procedures designed to address assertion-level RMMs.

Why do we apply both overall and assertion-level responses? [ISA | 782.1600]

To illustrate why we apply both overall and assertion-level responses to appropriately respond to risks, consider this non-financial example.

> In our daily lives, we often perform activities whose success depends on a combination of both overall and specific approaches. Consider gardening, for example. We take some actions that are intended to affect only certain plants, such as pruning, relocating a plant to get more or less sun, or watering selectively.
>
> However, we also act in ways that are intended to affect the entire garden. We might change the soil, apply fertilizer or adjust the overall watering schedule. Ultimately, the combination of both types of activity is what helps us maintain a healthy garden.

3 Design and perform procedures to address each RMM [ISA | 587]

What do we do?

Design and perform audit procedures whose nature, timing and extent address the risks of material misstatement for each assertion of each significant account and disclosure and in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory

Why do we do this?

To meet our audit objectives, we reduce audit risk to an appropriately low level by obtaining persuasive - i.e. sufficient and appropriate - audit evidence.

To reduce audit risk, we design and perform audit procedures for each RMM for each significant account, disclosure and relevant assertions. When designing and performing these audit procedures, we can take a controls based approach or a substantive approach for each RMM.

If we are biased when we design and perform our audit procedures, then we may fail to obtain sufficient and appropriate audit evidence and draw the wrong conclusions on which we base our audit opinion.

Execute the Audit

What is our objective when performing a financial statement audit? [ISA | 587.1400]

Our audit objective is to provide reasonable assurance that the financial statements are free of material misstatement (whether due to error or fraud). We accomplish this audit objective by reducing audit risk to an appropriately low level.

What is audit risk? [ISA | 587.1500]

Simply stated, audit risk is the possibility that we will reach the wrong overall conclusion in our audit - i.e. that we express an unqualified audit opinion when the financial statements are materially misstated.

What are the components of audit risk? [ISA | 587.10999]

Audit risk has two primary components.

Risk of material misstatement	The risk that the financial statements are materially misstated	Exists independently of the audit
Detection risk	The risk that our audit procedures fail to detect that material misstatement	Influenced by what we do in the audit

How do we reduce audit risk to an appropriately low level? [ISA | 587.1600]

To reduce audit risk to an appropriately low level, we design and perform audit procedures to obtain persuasive evidence over each risk of material misstatement identified. We design and perform these procedures in a manner that is not biased towards obtaining corroborative audit evidence or towards excluding contradictory audit evidence.

We maintain professional skepticism when evaluating audit evidence with respect to the RMM, including when:

- considering information that may be used as audit evidence (corroborative or contradictory), and
- what procedures would be appropriate in the circumstances.

What do we consider when designing our audit procedures? [ISA | 587.11161]

When we design our audit procedures, we consider:

- the type, likelihood, and magnitude of potential misstatements that may result from the identified risks (i.e. inherent risk);
- whether we intend to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures (i.e. control risk); and
- the persuasiveness of evidence we need, based on our risk assessment.

What is persuasive evidence? [ISA | 587.1900]

Persuasive evidence is evidence that makes a more credible argument or strengthens our 'belief' in the results of our testing. To be persuasive, the evidence has to be sufficient (i.e. quantity) and appropriate (i.e. quality) audit evidence. Some types of evidence we gather are more persuasive than

others. We may calibrate the level of audit evidence we plan to obtain by altering the nature, timing and/or extent of our audit procedures.

How do we assess risk for assertion-level RMMs? [ISA | 587.2000]

Our assessment of the risk for assertion-level RMMs is a function of two separate components - inherent risk and control risk. We call this assessment combined assessed risk (CAR).

We assess CAR for each identified assertion-level RMM.

Our CAR assessment influences the substantive procedures we design and perform to reduce detection risk to the appropriate level, and therefore reduce audit risk.

What is inherent risk? [ISA | 587.11000]

Inherent risk is the susceptibility of an assertion to a misstatement that may be material, before considering related control activities.

> For example, consider the inherent risk of having an accident while driving. We most likely assess the risk of city driving as higher than the risk of driving on the freeway or motorway. This is because city driving has many different hazards - e.g. lots of pedestrians and other cars - whereas a freeway may have fewer hazards - i.e. it's an open road with few other cars.
>
> When thinking about the inherent risk, we do not consider the potential controls in place, such as speed limits, road signs, and stop lights.

The same concept applies to auditing - certain accounts, disclosures and assertions are inherently riskier than others are. Inherent risk may be greater when transactions are complex, or in situations that include estimates with a high degree of uncertainty.

What is control risk? [ISA | 587.11001]

Control risk is the risk that an entity's controls will fail to prevent or detect a material misstatement on a timely basis. Control risk is lower when the controls associated with a particular assertion are designed and operating effectively.

Essentially, control risk relates to how effective the controls are in reducing audit risk - in the same way that effective speed limits, road signs and stop lights can reduce the risk of having an accident while driving.

Similar to inherent risk, control risk exists independent of the audit. But unlike inherent risk, control risk is something that management can influence: the stronger an entity's controls over financial reporting, the lower control risk becomes.

However, while the strength of an entity's controls can have an impact on audit risk, we only factor that into our assessment of CAR when we obtain sufficient evidence over the design, implementation and operating effectiveness of the relevant control activities.

Due to the inherent limitations of internal control - e.g. human error or management override - some control risk will always exist.

What is the CAR matrix? [ISA | 587.2100]

The CAR matrix provides our CAR assessment, based on our individual assessments of inherent risk and control risk for each assertion-level RMM.

	Control risk (CR)	
Inherent risk (IR)	No Controls Reliance (N)	Controls Reliance (C)
Significant (S)	**SN**	**SC**
Elevated (E)	**EN**	**EC**
Base (B)	**BN**	**BC**

How does persuasive evidence relate to CAR? [ISA | 587.2200]

We gather more persuasive audit evidence for those RMMs that have a higher CAR (i.e. EN, EC, SN, SC).

We may calibrate the level of audit evidence we plan to obtain by altering the nature, timing and/or extent of our tests of controls or substantive procedures.

What types of audit procedures can we design? [ISA | 587.2400]

In a financial statement audit, our procedures may include tests of controls - i.e. testing their operating effectiveness - and/or substantive procedures.

Effective controls allow us to alter the nature, timing and extent of substantive procedures. This allows us to obtain evidence that is less persuasive than we planned to obtain had we not tested controls and found them effective.

In some cases, we may decide that substantive procedures alone are the most appropriate audit response - for example, because:

- our risk assessment procedures did not identify relevant process control activities over the process risk points related to the RMM; or
- testing controls is inefficient.

In such cases, we may not rely on the operating effectiveness of controls to determine the nature, timing and extent of substantive procedures.

Tests of controls alone provide insufficient evidence to conclude on an RMM. Even when we plan to test controls, we still perform substantive procedures for each RMM.

The combination of substantive procedures and tests of controls, including the nature, timing and extent of those tests, may differ for each RMM.

4 Obtain evidence about the operating effectiveness of controls [ISA | 1279]

What do we do?

Obtain audit evidence about the operating effectiveness of the controls, including how the controls were applied at relevant times, the consistency with which they were applied, and by whom or what means they were applied.

Why do we do this?

When we test the operating effectiveness of a controls, we obtain evidence to support the controls' operation. This includes obtaining evidence to support:

- how the controls were applied during the year;
- how consistently they were applied; and
- who or by what means the control was applied.

These aspects of the control's operation help us evaluate whether the control was performed consistently and effectively throughout the period.

Execute the Audit

What evidence do we obtain about the operating effectiveness of controls? [ISA | 1279.1300]

We perform inquiries and other audit procedures to directly test and obtain evidence about the operating effectiveness of a control, including evidence about:

- how the control was applied at relevant times during the period under audit;
- the consistency with which it was applied; and
- who or by what means the control was applied

How do we obtain evidence about how the control was applied at relevant times? [ISA | 1279.1400]

When we obtain evidence about how the control was applied at relevant times during the period under audit, we:

- obtain a complete population of the items over which the control should have been applied or performed;
- select an appropriate number of these items to test; and
- assess whether the control operated as designed and in a timely manner over each selected item.

Why do we consider whether a control was performed in a timely manner? [ISA | 1279.12111]

We consider whether a control was performed in a timely manner because a material misstatement could exist until the control is performed. If the period of time between when a control is expected to

be performed and when it is actually performed spans reporting periods, the control's lack of timely operation may fail to prevent and/or detect a material misstatement to the financial statements.

When we obtain evidence that a control did not operate when it was designed to or in a timely manner, we conclude that the control is not operating effectively and we do not rely on it.

How do we obtain evidence about whether the control was consistently applied? [ISA | 1279.1500]

When we obtain evidence about whether a control was consistently applied, we:

- select items from a complete population of transactions or instances when the control is expected to have been applied or performed; and
- determine whether the control operated as designed for each of those instances.

How do we obtain evidence about who or by what means the control was applied? [ISA | 1279.1600]

We obtain evidence about who or by what means a control was applied through various procedures, including inquiry, observation, inspection or reperformance.

> For example, we may inquire of management and learn that the accounting manager performs the quarterly review of bank reconciliations. We may obtain evidence about who - i.e. the accounting manager - and by what means - i.e. quarterly manual review - the bank reconciliation review is applied by inquiring of the accounting manager and inspecting a bank reconciliation to evidence their review.

A control can be manual or automated.

- **Manual controls** are applied by people.
- **Automated controls** are applied by IT systems.

How do we obtain evidence about the operation of an automated control? [ISA | 1279.8432]

When we obtain evidence about the implementation/operation of an automated control, we obtain evidence about whether the control was performed by the IT systems in a manner that is consistent with its design.

We may obtain evidence about an automated control's continued operation throughout the period by testing GITCs.

How do we obtain evidence about who or by what means a manual control was applied? [ISA | 1279.12116]

For manual controls, we obtain evidence that the control operator(s), having both the authority and competence to perform the control effectively, has performed the control in a manner that is consistent with its design for those control(s) selected for testing.

We assess whether the control operator(s) has the right level of authority and competence as part of evaluating the design of the control. Refer to activity 'Understand the authority and competence of the control operator' in the risk assessment chapter for guidance on assessing the authority and competence of the control operator.

What do we document when we test the operating effectiveness of controls? [ISA | 1279.1700]

We document:

- a description of the nature, timing and extent of our tests of operating effectiveness;
- the linkage of those procedures with the RMM; and
- the results of our tests of operating effectiveness, including the conclusions where these are not otherwise clear.

How do we test the operating effectiveness of control activities that involve judgment? [ISA | 1279.1800]

We test the operating effectiveness of a control activity that involves judgment in the same way as we test any other control, except, for each instance of the control we test, we also:

- evaluate the steps performed by the control operator to identify and investigate outliers, including whether outliers were appropriately identified; and
- evaluate the conclusions reached in the control operator's investigation, including whether all outliers were appropriately investigated and whether corrective actions were taken as needed.

Because the control operator uses judgment, we obtain more persuasive evidence than we do for other controls involving no judgment, especially as it relates to understanding any judgmental criteria applied by the control operator for identifying and investigating outliers.

We also pay attention to the consistent application of judgmental criteria, where applicable, through the evaluation and tests of implementation and operating effectiveness.

Is an outlier a misstatement? [ISA | 1279.12091]

Not always. Outliers do not necessarily lead to misstatements. Rather, it triggers the control operator to further investigate in order to:

- confirm the appropriateness of the outlier;
- identify whether or not the outlier:
  - is an error that needs correction; or
  - otherwise indicates that the related account balance contains an error; and
- determine whether further information or activities are needed to resolve the matter.

If we identify the same outliers, can we conclude the control activity that involves judgment is operating effectively? [ISA | 1279.12119]

No. Even if we use reperformance and identify the same outliers as the control operator, we can't conclude that the control activity is operating effectively until we:

- determine whether the conclusions reached in the control operator's investigation were appropriate; and
- evaluate how the control operator investigated and resolved the outliers, including whether:
  - outliers were appropriately investigated; and
  - corrective actions were taken as needed.

Like any other detective control, we also test the entity's process to resolve any outliers.

What do we do when we do not identify any outliers when reperforming a control activity that involves judgment? [ISA | 1279.12120]

In evaluating the design and implementation and testing of operating effectiveness over control activities that involve judgment, the engagement team may still conclude that the control is designed,

implemented and operating effectively when the control does not identify any outliers. An engagement team may conclude that:

- the control activity is:
  - designed effectively with a sufficient precision to prevent, or detect and correct, a material misstatement in a timely manner over the financial statement assertions it is intended to address (process control activities); or
  - designed effectively to address the relevant RAFIT (GITCs), and
- control operator has performed the control as designed and identifying no outliers is appropriate based on the control activity's design.

Keep in mind that the criteria for investigation used by the control operator to identify outliers is an important element of the control's design, especially when the control activity involves judgment. Evaluating whether the criteria are sufficient to achieve the control's objective requires careful evaluation.

What do we consider when the control activity that involves judgment identifies a large number of outliers? [ISA | 1279.12121]

When we reperform a control activity that involves judgment and identify a large number of outliers, we may consider whether other controls are missing or deficient, putting pressure on the control activity involving judgment and affecting its ability to operate effectively.

Examples

How many outliers represent sufficient evidence of operating effectiveness? [ISA | 1279.1900]

Fact pattern

Management has a significant securities investment portfolio consisting primarily of Level 1 and Level 2 securities. Management performs a review control related to the valuation of investment securities. As part of the control attributes, management investigates any prices provided by two independent third-party service providers that vary by 2 percent - i.e. the criteria for investigation is to review any variance greater than 2 percent and an outlier is any variance outside of that threshold. Based on the average historical values of the securities, a 2 percent variance is not individually material but could become material based on the aggregation of 2 percent variances of 5-10 individual securities.

Analysis

The engagement team considers several items. For example, what does history indicate is a normal variation between the prices of the two service providers?

- For Level 1 securities, there are likely no differences, so the 2 percent threshold is not likely to produce any outliers. Given the relatively high threshold compared to the expectation, this indicates that the threshold is not appropriate for Level 1 securities. However, when considering the 2 percent variance in relation to materiality, and the fact that no differences are expected, the threshold may be appropriate.
- For Level 2 securities, the third-party service providers' valuations may vary considerably by type of instrument. For some types of securities, many outliers would exceed the 2 percent threshold. For other types of securities, none would exceed the 2 percent threshold. This indicates that a 2 percent threshold is not appropriate for all types of securities.

The appropriateness of thresholds and the numbers of outliers they identify may also change over time because of changes in external and interior factors. The 2 percent threshold may appear high and identify no outliers for certain highly liquid securities at a time when securities are stable and predictable. However, when the market is uncertain, the same 2 percent threshold may become too narrow. It may therefore lead us to identify a greater number of outliers than is expected considering the uncertainty inherent in securities valuation.

There is no specified way to determine whether the number of outliers provides sufficient evidence or indicates that the threshold is appropriate. The determination may depend on careful evaluation of the design of the metrics, thresholds and other criteria used in the execution of the control, as well as the resolution of the identified outliers:

- If the prices from both third-party pricing services are the same for all Level 1 securities, there are no outliers. This does not mean that the control is ineffective because little to no difference is expected in the estimated prices.
- If only two outliers relate to a particular type of security classified as Level 2, that may or may not provide sufficient evidence.
    - If both outliers are investigated, an adjustment is needed, and there are several similar securities with price variations just below the threshold used to identify outliers, the threshold may need to be adjusted downward.
    - If neither outlier results in an adjustment and the remaining similar securities do not have variances close to the threshold, two outliers may be sufficient.

For situations between these two examples, judgment is used to determine whether the control is operating at a sufficient level of precision to detect or prevent a material misstatement.

5 Use a benchmarking strategy to test automated controls [ISA | 1271]

What do we do?

IF we plan to use a benchmarking strategy to conclude on the operating effectiveness of an automated control (excluding GITCs), THEN perform relevant procedures.

Why do we do this?

We obtain evidence about the design and effectiveness of controls during the period under audit, but we are permitted to use evidence from prior years when we take a benchmarking approach. There are limitations on when we can use benchmarking, and other evidence we obtain in the period of reliance in order to rely on benchmarking evidence.

Execute the Audit

Can we benchmark a general IT control (GITC)? [ISA | 1271.8478]

No, we do not use a benchmarking strategy for general IT controls (GITCs).

What is benchmarking? [ISA | 1271.1300]

Benchmarking automated controls uses a combination of audit evidence obtained in a past audit - i.e. the baseline - and audit evidence in the current year that the operation of the automated control has not changed, to conclude on whether the automated control is implemented and operating effectively in the current period under audit.

What is the baseline? [ISA | 1271.12068]

The baseline is the test we performed over the design, implementation and operating effectiveness of the automated control and the evidence we obtained to support its design, implementation and operating effectiveness in a past audit. This test is considered the baseline - or benchmark - for the automated control.

What do we do to test an automated control using benchmarking? [ISA | 1271.1500]

We do this in the following steps for automated controls:

- Determine whether it is appropriate to use a benchmarking strategy
  - Consider our assessment of RAWTC and other risk factors
  - Determine whether it is necessary to re-establish a baseline
- Determine the automated control has not changed since the baseline

Are there drawbacks to using a benchmarking strategy? [ISA | 1271.1600]

It depends. A benchmarking strategy may be less efficient than testing the operating effectiveness of the control in the current period. Even when a benchmarking strategy is appropriate, we decide whether to use it by weighing the incremental efficiency benefit against the additional risk.

In some cases, we may find that using a benchmarking strategy doesn't provide a significant benefit when compared to the increased risks.

Do we still obtain an understanding of the process and evaluate the design and implementation of automated controls when using a benchmarking approach? [ISA | 1271.1700]

Yes. When we use a benchmarking strategy, we still:

- understand the process;
- identify the applicable process risk points;
- evaluate the design of the automated controls; and
- test the operating effectiveness of the relevant general IT controls.

This is performed at the same time and in the same way as for controls that we do not benchmark. It's the next steps - the tests of implementation and operating effectiveness - where our benchmarking approach differs.

How do we evaluate the design of an automated control when we use a benchmarking strategy? [ISA | 1271.1800]

When we evaluate the design of automated controls we plan to test using a benchmarking strategy, we consider the combination of:

- evidence we obtained in prior periods when evaluating the design and implementation and testing the operating effectiveness as part of establishing the baseline; and

- evidence we obtain in the current period to determine that the automated control has not changed since the baseline and that no changes are necessary.

If we concluded the design of an automated control was effective in prior periods, does this automatically allow us to conclude the design is effective in the current period? [ISA | 1271.1900]

No. When we evaluate the design of the automated control in the current period, we cannot not simply conclude the automated control is designed effectively based on the conclusion reached during the past audit. We also consider whether there are any changes in circumstances since the baseline that may affect the design of the automated control, such as:

- changes in materiality;
- changes in processes and related process risk points - i.e., the where and how a material misstatement could occur;
- changes in related files, tables, data, and parameters the automated control relies on.

When changes are necessary and management has not updated the design of the automated control to address these changes, we conclude the design of the automated control is ineffective.

What do we include in our documentation when we use a benchmarking strategy? [ISA | 1271.2000]

When we plan to use a benchmarking strategy, we include in our audit documentation for the automated control:

- sufficient and appropriate audit evidence we obtained in the prior periods relating to our evaluation of the design and implementation of controls and our tests of their operating effectiveness;
- the procedures we performed to determine that the design of the subject controls have not changed since our last evaluation;
- the date we last performed the baseline; and
- the conclusions we reached about relying on controls that were tested in previous audit.

Do we perform rollforward procedures when we use a benchmarking approach? [ISA | 1271.8479]

When our procedures to evaluate the appropriateness of using a benchmarking approach (e.g. determining the automated control has not changed) are performed prior to period end, then we perform rollforward procedures (see activity 'Determine additional evidence for the rollforward period, if applicable').

6 Core and Less Complex | Use prior year audit evidence for testing automated process control activities [ISA | 4583]

What do we do?

Incorporate knowledge obtained during past audits when determining the nature, timing, and extent of tests of controls in subsequent years

Why do we do this?

In planning an effective and efficient audit, we may be able rely on prior period audit evidence regarding the operating effectiveness of automated process control activities, where deemed appropriate.

Execute the Audit

Core and Less Complex | When can we use the audit evidence obtained during previous audits to conclude on the operating effectiveness of automated process control activities? [ISA | 4583.1300]

We can do this if we choose to use a benchmarking strategy to conclude on the operating effectiveness of automated process control activities. We still obtain evidence as part of the current audit to:

- ascertain whether the design of the automated process control activity has changed from prior periods; and
- determine that relevant general IT controls are operating effectively.

We also incorporate knowledge obtained during prior audits when determining the nature, timing, and extent of evidence necessary to conclude on the operating effectiveness of the automated process control activity for the current audit.

How do we incorporate knowledge obtained during previous audits when determining the nature, timing, and extent of our control testing? [ISA | 4583.1400]

To incorporate knowledge obtained during previous audits, we think about the following when assessing risk associated with a control in the subsequent years' audit:

- The nature, timing, and extent of procedures performed in previous audits;
- The results of the previous years' testing of the control; and
- Whether there have been changes in the control or the process in which it operates since the previous audit.

What do we do to incorporate knowledge obtained during past audits in subsequent years when determining the nature, timing and extent of our control testing? [ISA | 4583.12093]

To incorporate knowledge obtained during past audits when determining the nature, timing, and extent of tests of controls in subsequent years, we:

- Take additional factors into account when we assess risk associated with controls.
- Use a benchmarking strategy to test the effectiveness of automated process control activities, if applicable.
- Vary the nature, timing, and extent of tests of controls to incorporate unpredictability and respond to changes.

How do we incorporate the results of the previous year's testing of the control? [ISA | 4583.12095]

After we take into account the factors when we assess the risk associated with the control (RAWTC), the additional information from prior year might result in us assessing the RAWTC lower than in the previous year when we had increased the RAWTC above inherent risk in the previous year.

7 Core and Less Complex | Use prior period audit evidence for testing of manual process control activities [ISA | 5580]

What do we do?

IF we plan to use audit evidence obtained on prior period audits to conclude on the operating effectiveness of a manual process control activity, THEN perform relevant procedures.

Why do we do this?

We determine whether it is appropriate to use evidence about the operating effectiveness of process control activities obtained in prior periods. When those relevant controls are manual in nature and rely on the performance by an individual, there is a greater risk that the manual control will not continue to operate on a consistent basis.

Accordingly, we consider factors to help us determine whether it is appropriate to use evidence about the operating effectiveness of manual controls obtained in prior periods.

Execute the Audit

Core and Less Complex | In what circumstances may we use prior period audit evidence to conclude on the operating effectiveness of manual process control activities? [ISA | 5580.1300]

We may use prior period audit evidence for the operating effectiveness of manual process control activities in the current period when all of the following conditions are met:

- the risk associated with the control (RAWTC) is not assessed as Significant or Significant+;
- we have performed procedures to establish the continuing relevance and reliability of the prior period audit evidence by:
  - performing a walkthrough of the business process containing the control; and
  - evaluating that both the design and implementation is effective in the current period and has not significantly changed from the previous audit;
- we have evaluated the Monitoring Activities component of CERAMIC and concluded that it is appropriate; and
- we have tested the operating effectiveness of the control at least once in the past two audit periods.

Core and Less Complex | How does our evaluation of the Monitoring Activities component of CERAMIC help us establish the continuing relevance and reliability of prior period audit evidence in a smaller entity? [ISA | 5580.6244]

In a smaller entity, the Monitoring Activities component of CERAMIC helps to establish the continuing relevance and reliability of prior period audit evidence, as management's close involvement in operations and monitoring improves the likelihood that management will be aware of any changes in controls and inform us accordingly.

Core and Less Complex | How do we establish the continuing relevance and reliability of evidence from previous audits? [ISA | 5580.12220]

When we plan to use the audit evidence obtained in the prior period about the operating effectiveness of manual process control activities, we 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. We obtain this evidence by performing the following procedures:

- we perform a walkthrough of the business process containing the control we intend to use audit evidence from previous audits in order to confirm our understanding of (i) this business process, (ii) those specific controls and (iii) whether there have been any significant changes in the activities or "the process risk point" in the process;
- we evaluate the design and implementation of the control we rely on in the current period and we conclude that both the design and implementation is effective in the current period and has not significantly changed since the previous audit.

Core and Less Complex | What if there have been significant changes to the manual process control activities since the previous audit? [ISA | 5580.1500]

When there have been significant changes to the design of the manual process control activities that affect the continuing relevance and reliability of the audit evidence from the previous audit, we re-test the operating effectiveness of the control for the period since the control changed in the current audit if we still plan to rely on this specific control.

Core and Less Complex | How often do we re-test the operating effectiveness of manual process control activities where we use prior period audit evidence? [ISA | 5580.1600]

The length of time between retesting the operating effectiveness of the process control activities we are relying on is a matter of professional judgment. However, we re-test the operating effectiveness of the manual process control activity we are relying on at least once every three audit periods - i.e. if we tested the operating effectiveness of a control in audit period one, then we re-test the operating effectiveness in audit period four at the latest.

When we intend to use audit evidence obtained in previous audits for multiple manual process control activities, we stagger our testing so that we perform some testing during each audit. This provides corroborating information about the continuing effectiveness of the control environment and contributes to our decision about whether it is appropriate to use audit evidence obtained in previous audit for other manual process control activities.

Core and Less Complex | What do we consider when determining whether to re-test the operating effectiveness of manual process control activities in the current period? [ISA | 5580.1700]

In addition to considering whether the testing of the operating effectiveness of the manual process control activity was performed at least once in the past two audit periods, we also consider several factors when determining whether to re-test the operating effectiveness of the control or if use of audit evidence obtained in previous audits remains appropriate.

Factors that decrease the period for retesting a manual process control activity or potentially result in not using on audit evidence obtained on previous audits at all, include:

- a deficient control environment;

- deficient monitoring of controls;
- changing circumstances that indicate the need for changes in the control;
- higher RAWTC, i.e. the higher the RAWTC, the shorter the period between testing or, in some cases, less likely to use evidence from the previous audits.

Factor	Indicator to re-test operating effectiveness	Indicator that the previous testing of the operating effectiveness is still appropriate (assuming the control was tested at least once in the past two audit periods)
Effectiveness of other components of internal control, including the Control Environment, the Monitoring Activities, and Risk Assessment components	The Control Environment, Monitoring Activities, and Risk Assessment components of CERAMIC are not appropriate. If the Monitoring Activities component is not appropriate, the use of prior period audit evidence is no longer appropriate.	The Control Environment, Monitoring Activities, and Risk Assessment components of CERAMIC are appropriate.
Changing circumstances that indicate the need for changes in the control	We identified changing circumstances that indicate changes in the operation of the manual process control activity are necessary. When there have been significant changes in the entity and its environment, process activities and/or process risk points (PRPs), modifications to the control and how it operates are generally necessary for the control to continue to mitigate the relevant risks.	We did not identify any changing circumstances that indicate changes in the operation of the manual process control activity are necessary.
The RAWTC of the control	When RAWTC is Elevated, the potential implications of a control failure are often greater. As a result, more frequent testing (i.e., more frequently	When RAWTC is Base, the likelihood that the control will fail to operate effectively is lower. As a result, less frequent testing (i.e., once every three periods) is appropriate.

	than once every three periods) is appropriate. When RAWTC is Significant or Significant+, the use of prior period audit evidence is not allowed.	

Core and Less Complex | How do we incorporate the results of the previous period's testing of the control? [ISA | 5580.1800]

If we plan to use audit evidence about the operating effectiveness of a manual process control activity obtained in previous audits, we include in our audit documentation:

- Audit evidence from prior periods relating to our evaluation of the design and implementation of the specific control and our test of the operating effectiveness;
- Procedures performed to determine that no changes in the design or implementation of the subject manual control have occurred since we last tested the controls;
- Conclusions reached about relying on such manual control that was tested in a previous audit.

Core and Less Complex | Do we perform rollforward procedures when we use prior period evidence for testing manual process control activities? [ISA | 5580.7476]

When our procedures to evaluate the appropriateness of using prior period audit evidence (e.g. walkthrough of the business process and evaluation of design and implementation of the manual process control activity) are performed prior to period end, then we perform rollforward procedures (see activity 'Determine additional evidence for the rollforward period, if applicable').

8 Demonstrate that information in financial statements agrees or reconciles with the underlying accounting records [ISA | 1298]

What do we do?

Prepare audit documentation to demonstrate that information in the financial statements and related disclosures agrees or reconciles with the underlying accounting records

Why do we do this?

Because audit documentation is the record that supports our opinion, we demonstrate that the information in the financial statements and related disclosures agrees or reconciles to the underlying accounting records. This provides a clear link to our procedures performed and results obtained on the underlying records and thus that the account balances are presented appropriately in the financial statements.

Execute the Audit

What are 'underlying accounting records'? [ISA | 1298.1300]

Underlying accounting records include the general ledger and sub-ledgers, but also other information within the entity. This is often the information we perform our audit procedures over that is used by management to compile the financial statements.

What information in the financial statements do we reconcile? [ISA | 1298.13610]

We reconcile, or agree, the financial statements with underlying accounting records, including:

- the information in the financial statements, including reconciling comparative information to prior audited financial statements;
- the disclosures to the financial statements; and
- the presentation of the amounts in the financial statements.

How do we reconcile amounts in the financial statements with the underlying accounting records? [ISA | 1298.1400]

How we reconcile, or agree, amounts on the face of the financial statements and related disclosures with the underlying accounting records depends on the complexity of the entity's period-end financial reporting process.

In a smaller or less complex entity, our audit documentation may include schedules to evidence that we agreed the amounts in the financial statements directly to the entity's trial balance or general ledger we used for our audit procedures.

In a more complex entity with multiple subsidiaries, we may agree the amounts in the financial statements to a consolidation schedule, which we reconcile to the individual trial balances or supporting ledgers.

We also determine whether the prior-period amounts have been recorded or revised correctly.

Group audit | How do we reconcile amounts in the group financial statements with the underlying accounting records? [ISA | 1298.159835]

How we reconcile, or agree, amounts on the face of the group financial statements and related disclosures with the underlying accounting records depends on the complexity of the group's period-end financial reporting process.

We may agree the amounts in the group financial statements to a consolidation schedule, which we reconcile to the component reporting packages for components were further audit procedures are performed. The component reporting packages are reconciled to the component's trial balance or general ledger used in our audit procedures over that component.

We also determine whether the prior-period amounts have been recorded or revised correctly.

How do we reconcile financial statement disclosures? [ISA | 1298.1500]

Reconciling financial statement disclosures may involve checking the appropriateness of calculations and reconciling the amounts used in the calculations to the underlying accounting records, which may be the trial balance, general ledger, or other supporting documents.

One of the key objectives of reconciling the financial statements to the underlying accounting records is to determine whether the account balances and underlying transactions are presented appropriately in the financial statements and related disclosures. Through all of the risk assessment procedures, control testing and substantive audit procedures that we have performed throughout our audit, we

have gained an understanding of the types of balances and transactions included within the entity's accounting records. With that understanding in mind, reconciling the accounting records to the financial statements is one of the steps we perform in evaluating whether amounts are presented in the appropriate financial statement captions or disclosures.

Practically speaking, we accomplish this by asking ourselves questions such as the following.

- Are the descriptions of the underlying accounting records representative of the underlying account balance and/or transactions?
- Based on the descriptions of the underlying accounting records, are they presented appropriately within the financial statement captions?
- Are there transactions or balances with specific characteristics that need special consideration when reconciling the accounting records to the financial statements (e.g. the presentation of unpaid capital expenditures within the statement of cash flows)?
- Are there financial statement captions that need to be broken out into further detail based on the financial reporting framework or the needs of the users of the financial statements?

What is our responsibility for reconciling disclosures to the underlying accounting records? [ISA | 1298.13611]

At a minimum, we reconcile all of the entity's disclosures back to the underlying accounting records or prior year audited information, regardless of the assessed level of risk of each disclosure.

If there are account balances for which we did not identify a RMM, do we reconcile those to the underlying accounting records? [ISA | 1298.13612]

Yes. We reconcile all amounts in the financial statements, including disclosures, to the underlying accounting records even if we did not identify a RMM. In addition, we determine that all the general ledger balances are included in the financial statements.

Are there situations where we agree or reconcile the financial statements to information obtained from outside of the general ledger and subsidiary ledgers? [ISA | 1298.1700]

Yes. There may be situations where we agree or reconcile information in the financial statements to information obtained from outside the general ledger and subsidiary ledgers. For example, a guarantee issued by an entity and disclosed in the financial statements is likely not recorded in the general ledger and/or subsidiary ledger. In this situation, we would reconcile this information obtained from outside the general ledger and subsidiary ledgers to this disclosure, such as the guarantee contract.

Do we evaluate the relevance and reliability of the information used to agree or reconcile the financial statements and related disclosures? [ISA | 1298.159601]

Yes. We evaluate the relevance and reliability of the information used to agree or reconcile the financial statements and related disclosures, regardless of the assessed level of risk (RM or RMM) and regardless of whether the information is from within or outside the general ledger and/or subsidiary ledger.

Information used in disclosures may already be assessed separately as part of a separate response to an RMM or as part of a risk assessment procedure when identifying an RM.

If information is not separately evaluated for relevance and reliability elsewhere, we determine the appropriate audit procedures to evaluate the reliability of the information based on our understanding of the source and nature of the information and the circumstances under which it is obtained and how the information is being used in the audit.

When we have identified a disclosure amount as an RM and are using information only to perform the required reconciliation procedure we treat it akin to how we evaluate reliability of information used in a risk assessment procedure in activity 'Evaluate the relevance and reliability of information used as audit evidence.'

How do we prepare audit documentation to demonstrate the financial statements agree or reconcile with the underlying accounting records? [ISA | 1298.1600]

In our audit documentation, we include schedules to clearly evidence that the information in the financial statements agrees to, or reconciles with, the underlying accounting records. This can include information obtained from within or outside of the general and subsidiary ledgers.

We include a financial statement 'tie-out' in the workpapers that evidences how the financial statements and disclosures reconcile with the underlying accounting records. Ordinarily, this is the trial balance, along with other subsidiary ledgers (e.g. AR or AP subledgers).

If we have identified a RMM within the business process that includes the underlying accounting records and have performed audit procedures over the information and all RDEs, we consider linking to our audit procedures to show how our audit procedures relate to the balances that we reconcile to the financial statements, providing a clear trail from the financial statements to the audit procedures performed.

> For example, if we utilize a population of payroll expenses to support our procedures performed over the accuracy of Selling, General & Administrative (SG&A) expenses, our documentation evidences how the trial balance and the financial statement caption for SG&A expenses reconciles to the population of payroll expenses (underlying record)that we tested.

Examples

What are examples of how we might evaluate information used in reconciling all amounts within a disclosure? [ISA | 1298.159836]

Underlying accounting record (information)	Inherent risk for RMMs or RMs related to the disclosure	How we might evaluate the relevance and reliability of the information
Future minimum lease payments. A preconfigured report from the Company's lease application generates the future minimum	Engagement team determined there was not an RMM related to the presentation and disclosure of future minimum lease payments based on:	- As the report is extracted from the lease application that captures the lease, it is considered relevant,

lease payments used for this disclosure. The preconfigured report represents the underlying accounting records.	- low volume of leases and no lease modifications in the current year; - no changes in lease accounting policies; - stability in the discount rate; and - expectation of minimal changes to the disclosure.	- Inquire to understand the nature, source and RDEs to generate the report, - Compare the future minimum lease payments for the current year to the prior year schedule to identify if there are any unexpected changes in the data to assess the reliability.
Advertising expense derived directly from the company's general ledger. The advertising expenses in the general ledger represents the underlying accounting records.	Engagement team determined there was not an RMM related to the presentation of advertising cost disclosures based on: - no judgment required to record advertising expense; - no prior period misstatements or deficiencies were identified; and - no changes in the related accounting policies.	Agreed amount to the general ledger. No additional procedures needed to assess relevance and reliability as the general ledger is subject to other audit procedures.
Revenue disaggregation by category. The entity discloses revenue by country, which is derived from a system generated report from the revenue sub-ledger. The report represents the underlying accounting records.	Engagement team determined an RMM with a base inherent risk for the revenue disaggregation component of the disclosure based on: - high volume of revenue transactions in the current period; and - importance of revenue disclosures to users of the financial statement.	No additional procedures needed to assess relevance and reliability as other procedures as: - the report and the relevant data elements, including the category of revenue that is used to determine the disaggregated disclosure, were identified as information in management's disclosure control of the Revenue Note; and - the report was tested in accordance with activity 'Evaluate the relevance and

		reliability of information used as audit evidence'

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